

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240

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**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**

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (“Commission”) is adopting rules under the Securities Exchange Act of 1934 (“Exchange Act”) to amend the standards applicable to covered clearing agencies for U.S. Treasury securities to require that such covered clearing agencies have written policies and procedures reasonably designed to require that every direct participant of the covered clearing agency submit for clearance and settlement all eligible secondary market transactions in U.S. Treasury securities to which it is a counterparty. In addition, the Commission is adopting additional amendments to the Covered Clearing Agency Standards with respect to risk management. These requirements are designed to protect investors, reduce risk, and increase operational efficiency. Finally, the Commission is amending the broker-dealer customer protection rule to permit margin required and on deposit with covered clearing agencies for U.S. Treasury securities to be included as a debit in the reserve formulas for accounts of customers and proprietary accounts of broker-dealers (“PAB”), subject to certain conditions.

DATES: *Effective date:* [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

Compliance date: The applicable compliance dates are discussed in Part III of this release.

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SUPPLEMENTARY INFORMATION: First, the Commission is amending 17 CFR 240.17ad-22(e)(18) (“Rule 17ad-22(e)(18)”) to require covered clearing agencies that provide central counterparty (“CCP”) services for U.S. Treasury securities to establish, implement, maintain and enforce written policies and procedures reasonably designed, as applicable, to establish objective, risk-based and publicly disclosed criteria for participation, which require that any direct participant of such a covered clearing agency submit for clearance and settlement all the eligible secondary market transactions in U.S. Treasury securities to which such direct participant is a counterparty. In addition, these policies and procedures must be reasonably designed, as applicable, to identify and monitor the covered clearing agency’s direct participants’ submission of transactions for clearing as required above, including how the covered clearing agency would address a failure to submit transactions. These policies and procedures must also be reasonably designed, as applicable, to ensure that the covered clearing agency 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, which policies and procedures the board of directors of such U.S. Treasury securities covered clearing agency (“CCA”) must review annually.

The Commission is defining an eligible secondary market transaction as a secondary market transaction in U.S. Treasury securities of a type accepted for clearing by a registered covered clearing agency that is either a repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities, in which one of the counterparties is a direct participant, or certain specified categories of cash purchase or sale transactions, including certain exclusions for transactions with sovereign entities, international financial institutions, natural persons, inter-affiliate repo transactions, state/local governments, and other clearing organizations. Second, the Commission is amending 17 CFR 240.17ad-22(e)(6)(i) (“Rule 17ad-22(e)(6)(i)”) to require that a covered clearing agency providing central counterparty services for U.S. Treasury securities establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin for transactions in U.S. Treasury securities submitted on behalf of an indirect participant separately from those submitted on behalf of the direct participant. Third, the Commission is amending Rule 17ad-22(e)(18) to require that a covered clearing agency providing central counterparty services for U.S. Treasury securities establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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, which policies and procedures the board of directors of such covered clearing agency reviews annually. In connection with these proposed amendments, the Commission is including as part of 17 CFR 240.17ad-22(a) (“Rule 17ad-22(a)”) definitions of “U.S. Treasury security,” “central bank,” “eligible secondary market transaction,” “international financial institution,” “sovereign entity,” “state and local government,” and “affiliated counterparty.” As part of this rulemaking,

the Commission is also amending the CFR designation of Rule 17Ad-22 to Rule 17ad-22.¹ Fourth, the Commission is amending 17 CFR 240.15c3-3a (“Rule 15c3-3a”) to permit margin required and on deposit at covered clearing agencies providing central counterparty services for U.S. Treasury securities to be included by broker-dealers as a debit in the customer and PAB reserve formulas, subject to certain conditions.

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¹ See note 71 *infra* for further discussion of this amendment. The Commission refers to the redesignated Rule 17ad-22 throughout this release.

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I. Introduction

The Commission is responsible for facilitating the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.² This responsibility includes the authority to regulate clearing agencies engaged in the clearance and settlement of government securities transactions, including U.S. Treasury securities.³ This inclusion of government securities, including U.S. Treasury securities, within the Commission’s authority for the national system of clearance and settlement underscores the importance of, among other things, the U.S. Treasury market.

U.S. Treasury securities play a critical and unique role in the U.S. and global economy, serving as a significant investment instrument and hedging vehicle for investors, a risk-free benchmark for other financial instruments, and an important mechanism for the Federal Reserve’s implementation of monetary policy.⁴ Consequently, 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.⁵

² See 15 U.S.C. 78q-1.

³ Government Securities Act of 1986, section 102(a); 15 U.S.C. 78c(a)(12)(B)(i).

⁴ See, e.g., 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, *Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report*, at 1 (Nov. 2021), available at <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf> (“Inter-Agency Working Group for Treasury Market Surveillance (“2021 IAWG 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, *Joint Staff Report: The U.S. Treasury Market on October 15, 2014*, at 1, 8 (2015), available at <https://home.treasury.gov/system/files/276/joint-staff-report-the-us-treasury-market-on-10-15-2014.pdf> (“Joint Staff Report”). These reports represent the views of Commission and other Federal regulatory staff. The reports are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content in the reports. These reports, like all staff reports, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

⁵ Group of Thirty Working Group on Treasury Market Liquidity, *U.S. Treasury Markets: Steps Toward Increased Resilience*, at 1 (2021), available at <https://group30.org/publications/detail/4950> (“G-30 Report”).

CCPs provide an important role for securities markets, interposing themselves between the counterparties to securities transactions, acting functionally as the buyer to every seller and the seller to every buyer. The Commission regulates CCPs as covered clearing agencies (“CCA”).⁶ The Commission historically has acknowledged the benefits that a CCP brings to the markets it serves. By novating transactions (that is, becoming the counterparty to both sides of a transaction), a CCP addresses concerns about counterparty risk by substituting its own creditworthiness and liquidity for the creditworthiness and liquidity of the counterparties.⁷ Further, the Commission has recognized that “the centralization of clearance and settlement activities at covered clearing agencies allows market participants to reduce costs, increase operational efficiency, and manage risks more effectively.”⁸ A CCP also provides a centralized system of default management that can mitigate the potential for a single market participant’s failure to destabilize other market participants or the financial system more broadly.⁹ However, the Commission has also recognized that this centralization of activity at clearing agencies makes risk management at such entities a critical function.

Because of the importance of risk management at CCPs and to further the establishment of linked and coordinated facilities for clearance and settlement of securities transactions, in 2016, the Commission adopted the Covered Clearing Agency Standards.¹⁰ These standards address all

⁶ See Rule 17ad-22(a) (defining covered clearing agency and central counterparty) and Exchange Act Section 3(a)(23) (defining clearing agency).

⁷ See, e.g., Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with Request of Liffe Administration and Management and Lch.Clearnet Ltd. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139, 140 (Jan. 2, 2009) (“Liffe Order”).

⁸ Covered Clearing Agency Standards Proposing Release, Exchange Act Release No. 71699 (Mar. 12, 2014), 79 FR 29507, 29587 (May 27, 2014) (“CCA Standards Proposing Release”).

⁹ See, e.g., Liffe Order, *supra* note 7, 74 FR at 140.

¹⁰ See Covered Clearing Agency Standards Adopting Release, Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786 (Oct. 13, 2016) (“CCA Standards Adopting Release”).

aspects of a CCP's operations, including financial risk management, operational risk, default management, governance, and participation requirements.¹¹ The Commission has had the opportunity to administer this new regulatory framework, considering many rule filings with respect to proposed rule changes filed by CCAs pursuant to their rule filing obligations as self-regulatory organizations ("SROs") under Section 19(b) of the Exchange Act that address how the proposed rule changes are consistent with the Exchange Act and the Covered Clearing Agency Standards thereunder.

The Commission also has had the opportunity to observe the U.S. Treasury market, including with respect to the clearance and settlement of U.S. Treasury security transactions in both the cash and repo market. In particular, the Commission understands that the proportion of transactions that are centrally cleared has declined over the past years. One recent analysis by the Treasury Market Practice Group¹² estimates that only 13 percent of the overall volume in U.S. dollars of U.S. Treasury cash transactions were centrally cleared as of the first half of 2017, and that an additional 19 percent were what the TMPG refers to as "hybrid" clearing, that is, executed on an interdealer broker platform (as discussed in parts II.A.1 and II.A.2.b.ii *infra*) in which one counterparty is a member of a CCA and submits its transaction with the interdealer broker for central clearing, while the other counterparty is not a member of a CCA and bilaterally clears its transaction with the interdealer broker.¹³ This use of both centrally cleared and not centrally

¹¹ See generally *id.*

¹² The Treasury Market Practices Group ("TMPG") is a group of "market professionals committed to supporting the integrity and efficiency of the Treasury, agency debt, and agency mortgage-backed securities markets." See Treasury Mark Practice Group, *About the TMPG*, available at <https://www.newyorkfed.org/TMPG/index.html>. The TMPG is sponsored by the Federal Reserve Bank of New York. *Id.*

¹³ TMPG, *White Paper on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities*, at 12 (July 2019), available at

cleared transactions introduces risk into the market, because bilateral clearing involves varying risk management practices that are less uniform and less transparent to the broader market and may be less efficient with regard to netting exposures and use of collateral as compared to central clearing.

Therefore, the Commission proposed amendments to Rule 17ad-22(e)(18) to help reduce contagion risk to the CCA and bring the benefits of central clearing to more transactions involving U.S. Treasury securities, thereby lowering overall systemic risk in the market.¹⁴ Specifically, the Commission proposed amendments that would require CCAs for the U.S. Treasury market to establish, implement, maintain and enforce written policies and procedures reasonably designed to require that their direct participants submit for clearance and settlement certain eligible secondary market transactions, both for repos and certain categories of cash transactions. In addition, the Commission proposed amendments to address certain other issues that could help facilitate increased central clearing in the U.S. These proposed changes included amending Rule 17ad-22(e)(6)(i) to require that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to calculate, collect, and hold proprietary margin separate from customer margin, amending Rule 17ad-22(e)(18) to require that CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that they have appropriate means to facilitate access to clearance and settlement services of all eligible secondary

https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS_FinalPaper_071119.pdf (“TMPG White Paper”). These estimates use FR2004 data, which are reports provided to the Federal Reserve Bank of New York regarding primary dealer market activity in U.S. Government securities, covering the first half of 2017 and are based on various assumptions specified in the TMPG White Paper. *See also* FR2004, Government Securities Dealer Reports, *available at* <https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDZq2f74T6b1cw>.

¹⁴ Proposing Release, 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 Act Release No. 95763 (Sept. 14, 2022), 87 FR 64610 (Oct. 25, 2022) (“Proposing Release”). *See also Report of the Joint Treasury-Federal Reserve Study of the U.S. Government Securities Market* (Apr. 1969), *available at* <https://fraser.stlouisfed.org/title/joint-treasury-federal-reserve-study-us-government-securities-market-318/report-joint-treasury-federal-reserve-study-us-government-securities-market-6282>.

market transactions in U.S. Treasury securities, including those of indirect participants, and amending Rule 15c3-3 to permit margin required and on deposit at covered clearing agencies providing central counterparty services for U.S. Treasury securities to be included by broker-dealers as a debit in the customer and PAB reserve formulas.

The Commission received many comments on the proposal.¹⁵ Having considered the comments received, the Commission is adopting the proposed new rules and rule amendments with modifications, as discussed further below.

II. Discussion of Comments Received and Final Rules

A. U.S. Treasury Securities CCA Membership Requirements

1. Requirement to Clear Eligible Secondary Market Transactions

Proposed Rule 17ad-22(e)(18)(iv)(A) would require that U.S. Treasury securities CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, establish objective, risk-based, and publicly disclosed criteria for participation, which require that the direct participants of such covered clearing agency submit for clearance and settlement all of the eligible secondary market transactions to which they are a counterparty. The proposed amendment would apply to “direct participants” in a U.S. Treasury securities CCA, which distinguishes entities that access a CCA directly (*i.e.*, members of the CCA) from indirect participants who “rely on the services provided by direct participants to access the covered clearing agency’s payment, clearing or settlement facilities.”¹⁶ For purposes of the Covered Clearing Agency Standards, “participants” of a CCA are referred to as “members” or “direct

¹⁵ Copies of all comment letters received by the Commission are available at <https://www.sec.gov/comments/s7-23-22/s72322.htm>.

¹⁶ 17 CFR 240.17ad-22(e)(19). *See also* CCA Standards Proposing Release, *supra* note 8, at 29553 (noting that some market participants would not meet a covered clearing agency’s direct participation requirements and proposing risk management requirements for indirect and tiered participants).

participants” to differentiate these entities from “direct participants’ customers” or “indirect participants.”¹⁷ Consequently, for purposes of this amendment and consistent with the terminology already used in the Covered Clearing Agency Standards,¹⁸ the term “direct participants” refers to the entities that directly access a U.S. Treasury securities CCA (generally banks and broker-dealers), and the term “indirect participants” would refer to those entities which rely on a direct participant to clear and settle their U.S. Treasury securities transactions with the U.S. Treasury securities CCA (generally their customers or clients, which typically include market participants such as money market funds, hedge funds, other asset managers, and smaller banks or broker-dealers).¹⁹

Moreover, persons who provide services in connection with clearance and settlement, such as settlement agent, settlement bank, or clearing bank services, and do not submit trades for clearing to a U.S. Treasury securities CCA would not be “direct participants” or “indirect

¹⁷ See, e.g., 17 CFR 240.17ad-22(e)(6) (referring to participants) and (e)(2)(vi) (referring to direct participants’ customers). In addition, the Exchange Act defines a participant of a clearing agency as “any person who uses a clearing agency to clear or settle securities transactions or to transfer, pledge, lend, or hypothecate securities.” 15 U.S.C. 78c(a)(24). Indirect participants are expressly excluded from the Exchange Act definition of a “participant” of a clearing agency because the Exchange Act provides that a person whose only use of a clearing agency is through another person who is a participant or as a pledgee of securities is not a “participant” of the clearing agency. *Id.*

¹⁸ See 17 CFR 240.17ad-22(e)(19) (referring to firms that are indirect participants in a covered clearing agency as those that “rely on the services provided by direct participants to access the covered clearing agency’s payment, clearing, or settlement facilities”).

¹⁹ For example, FICC maintains the Sponsored Service. See Fixed Income Clearing Corporation, Government Securities Division Rulebook, Rule 3A, available at https://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf (“FICC Rule”). Because sponsored members cannot clear or settle government securities transactions without a sponsoring member, the Commission believes that these sponsored members are not “direct participants.” As noted above, such persons are referred to in this release as “indirect participants” or “customers.”

participants” within the meaning of this amendment and the terminology used in the Covered Clearing Agency Standards.²⁰

In the Proposing Release, the Commission stated that it believes that the requirement to clear eligible secondary market transactions would promote the prompt and accurate clearance and settlement of U.S. Treasury securities transactions, providing several benefits to the market for U.S. Treasury securities as a whole,²¹ which are summarized briefly here.

First, the Commission stated that it believes that the requirement to clear eligible secondary market transactions would decrease the overall amount of counterparty credit risk in the secondary market for U.S. Treasury securities. Because a U.S. Treasury securities CCA would novate and guarantee each transaction submitted for central clearing, it would become a counterparty to each transaction, as the buyer to every seller and the seller to every buyer. The U.S. Treasury securities CCA would be able to risk manage these transactions centrally, pursuant to risk management procedures that the Commission has reviewed and approved,²² and would guarantee settlement of the trade in the event of a direct participant default.

In particular, the requirement to clear eligible secondary market transactions is designed to reduce the amount of “contagion risk” to a U.S. Treasury securities CCA arising from what has been described as “hybrid clearing,” as discussed in more detail in part II.A.2.b.iii. With this type of clearing, a direct participant’s transactions that are not submitted for central clearing pose an

²⁰ The Commission recognizes that some entities may access more limited services of a U.S. Treasury securities CCA without use of its CCP services. For example, FICC provides “comparison only” services for a certain membership type. *See* FICC Rule 8, *supra* note 19. Consistent with the definition of a “participant” under the Exchange Act, such entities would not be considered participants of a CCA and therefore would not be subject to any rules with respect to the clearing of eligible secondary market transactions that a CCA may adopt for its direct participants.

²¹ *See generally* Proposing Release, *supra* note 14, 87 FR at 64626-29; *see also* part IV.C.1 *infra*.

²² *See* Section 19(b) of the Exchange Act and Rule 19b-4 thereunder.

indirect risk to the covered clearing agency, as any default on a bilaterally settled transaction could impact the direct participant's financial resources and ability to meet its obligations to the covered clearing agency. The Commission stated that it believes that requiring U.S. Treasury securities CCAs to impose, as a condition of membership, an obligation on their direct participants to submit all eligible secondary market transactions for central clearing should address the transactions most likely to cause contagion risk to the CCA.

Second, the Commission stated that it believes that the requirement to clear eligible secondary market transactions would also help any U.S. Treasury securities CCA to avoid a potential disorderly member default. Defaults in bilaterally settled transactions are likely to be less orderly and subject to variable default management techniques because bilaterally settled transactions are not subject to the default management processes that are required to be in place and publicly disclosed at a CCP.²³ Centralized default management is a key feature of central clearing.²⁴ Because the CCP has novated and guaranteed the transactions, it is uniquely positioned to coordinate the default of a member for trades that it has centrally cleared, and the non-defaulting members can rely on the CCP to complete the transactions of the defaulting member and cover any resulting losses using the defaulting member's resources and/or its default management tools. Even in a situation where two CCPs have to coordinate the default of a joint member, that

²³ A covered clearing agency, including a U.S. Treasury securities CCA, is required to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, ensure the CCA has the authority and operational capacity to contain losses and liquidity demands and continue to meet its obligations, which must be tested annually, and publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures. *See* Rule 17ad-22(e)(13) and (e)(23)(i).

²⁴ CCA Standards Proposing Release, *supra* note 8, 79 FR at 29545 (a CCP's default management procedures would provide certainty and predictability about the measures available to a covered clearing agency in the event of a default which would, in turn facilitate the orderly handling of member defaults and would enable members to understand their obligations to the covered clearing agency in extreme circumstances).

coordination should result in more efficiency and market confidence than multiple bilateral settlements.

Third, the Commission stated that it believes that the requirement to clear eligible secondary market transactions will further the prompt and accurate clearance and settlement of U.S. Treasury securities by increasing the multilateral netting of transactions in these instruments, thereby reducing operational and liquidity risks, among others. Central clearing of transactions nets down gross exposures across participants, which reduces firms' exposures while positions are open and reduces the magnitude of cash and securities flows required at settlement.²⁵ As the Commission stated in the Proposing Release, FICC's failure to receive all eligible trading activity of an active market participant reduces the value of its vital multilateral netting process and causes FICC to be less well-situated to prevent future market crises.²⁶

The benefits of multilateral netting flowing from central clearing can improve market safety by lowering exposure to settlement failures, which would also tend to promote the prompt and accurate clearance and settlement of U.S. Treasury securities transactions.²⁷ Multilateral netting can also reduce the amount of balance sheet required for intermediation and could also enhance dealer capacity to make markets during normal times and stress events because existing

²⁵ 2021 IAWG Report, *supra* note 4, at 30.

²⁶ Proposing Release, *supra* note 14, 87 FR at 64628 & n. 182 (citing Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Trade Submission Requirements and Pre-Netting, Exchange Act Release No. 51908 (June 22, 2005), 70 FR 37450 (June 29, 2005) (describing a rule designed to bring additional transactions into FICC's netting system as "clearly designed to promote the prompt and accurate clearance and settlement of those transactions and to preserve the safety and soundness of the national clearance and settlement system.")).

²⁷ Darrell Duffie, *Still the World's Safe Haven Redesigning the U.S. Treasury Market After the COVID-19 Crisis*, Hutchins Center Working Paper # 62 (Brookings Inst.) at 15 (June 2020), available at https://www.brookings.edu/wp-content/uploads/2020/05/WP62_Duffie_v2.pdf ("Duffie").

bank capital and leverage requirements recognize the risk-reducing effects of multilateral netting of trades that CCP clearing accomplishes.²⁸

Fourth, the Commission stated that the potential benefits associated with the multilateral netting of transactions at a CCP that the requirement to clear eligible secondary market transactions is designed to bring about could, in turn, help to unlock further improvements in U.S. Treasury market structure. For example, the increase in clearing and consequent reduction in counterparty credit risk could “enhance the ability of smaller bank and independent dealers to compete with the incumbent bank dealers.”²⁹ Similarly, decreased counterparty credit risk – and potentially lower costs for intermediation – could result in narrower spreads, thereby enhancing market quality.³⁰ The Commission also stated that increased accessibility of central clearing in U.S. Treasury markets could support movement toward all-to-all trading, even potentially in the repo market, which would further improve market structure and resiliency, although a movement in that direction is not assured.³¹ This potential movement would stem from the fact that increased central clearing of U.S. Treasury securities transactions would, in turn, result in decreased counterparty risk, making all-to-all trading more attractive, that is, a market participant would be more willing to trade with any counterparty if a CCP were to serve as its ultimate counterparty.

²⁸ 2021 IAWG Report, *supra* note 4, at 30; Nellie Liang & Patrick Parkinson, *Enhancing Liquidity of the U.S. Treasury Market Under Stress*, at 9 (Dec. 16, 2020), available at https://www.brookings.edu/wp-content/uploads/2020/12/WP72_Liang-Parkinson.pdf (“Liang & Parkinson”); Duffie, *supra* note 27, at 16-17.

²⁹ Liang & Parkinson, *supra* note 28, at 9.

³⁰ G-30 Report, *supra* note 5, at 13.

³¹ 2021 IAWG Report, *supra* note 4, at 30; Duffie, *supra* note 27, at 16; G-30 Report, *supra* note 5, at 13. All-to-all trading would be characterized by the ability for a bid or offer submitted by one market participant to be accepted by any other market participant, with trades executed at the best bid or offer. *See, e.g.*, Liang & Parkinson, *supra* note 28, at 9. All-to-all trading could improve the quality of trade execution in normal market conditions and broaden and stabilize the supply of market liquidity under stress. *See, e.g.*, G-30 Report, *supra* note 5, at 10.

Finally, the Commission stated that increased central clearing should enhance regulatory visibility in the critically important U.S. Treasury market. Specifically, central clearing increases the transparency of settlement risk to regulators and market participants, and in particular allows a CCP to identify concentrated positions and crowded trades, adjusting margin requirements accordingly, which should help reduce significant risk to the CCP and to the system as a whole.³² In light of the role of U.S. Treasury securities in financing the Federal Government, it is important that regulators improve their visibility into this market. Increased central clearing would also allow for a more aggregated view of market activity in one place.

a. Comments Regarding the Requirement to Clear Eligible Secondary Market Transactions

Some commenters generally supported the proposal and its approach to requiring additional central clearing of transactions in U.S. Treasury securities.³³ However, other commenters generally opposed the proposed requirement to clear eligible secondary market transactions, arguing that there was not sufficient information on the costs and benefits of such a requirement, that the Commission should do further study, and/or that the Commission should incentivize additional clearing instead of requiring it.³⁴

³² Duffie, *supra* note 27, at 15; 2021 IAWG Report, *supra* note 4, at 30 (centralization of transactions at a CCP “can simplify data collection and improve visibility into market conditions for the authorities and, to some degree, for market participants”).

³³ See generally Letter from Americans for Financial Reform Education Fund (Dec. 27, 2022) (“AFREF Letter”); Letter from Stephen W. Hall, Legal Director and Securities Specialist, and Scott Farnin, Legal Counsel, Better Markets, Inc. (Dec. 23, 2022) (“Better Markets Letter”); Letter from Murray Pozmanter, Managing Director, President of DTCC Clearing Agency Services, Head of Global Business Operations, and Laura Klimpel, General Manager of FICC, Head of SIFMU Business Development, Depository Trust and Clearing Corporation and Fixed Income Clearing Corporation (Dec. 27, 2022) (“DTCC/FICC Letter”); Letter from Robin Vince, President and Chief Executive Officer, The Bank of New York Mellon Corporation (Dec. 22, 2022) (“BNY Mellon Letter”); Letter from Rachel Goldberg, Head of Government Relations and Regulatory Strategy, Americas, London Stock Exchange Group (Dec. 27, 2022) (“LSEG Letter”); Letter from Chris Edmonds, Chief Development Officer, Intercontinental Exchange, Inc. (Jan. 12, 2023) (“ICE Letter”).

³⁴ The Commission discusses the comments on incentives in its discussion of alternative approaches to a clearing requirement in part II.A.5 *infra*.

One commenter also referenced the need to assess the potential impact of an increased volume of cleared repo transactions on the Secured Overnight Financing Rate (“SOFR”), given its importance as a reference rate replacing LIBOR and because SOFR is calculated largely based on implied financing rates of repo transactions cleared at FICC.³⁵ SOFR is calculated as a volume-weighted median, which is the rate associated with transactions at the 50th percentile of transaction volume.³⁶ Specifically, the volume-weighted median rate is calculated by ordering the transactions from lowest to highest rate, taking the cumulative sum of volumes of these transactions, and identifying the rate associated with the trades at the 50th percentile of dollar volume. Such volume weighting should allow preparation of the rate to take into account any increased transaction volume arising from additional central clearing in response to a requirement to clear eligible secondary market transactions, thereby making further study unnecessary.

With respect to costs and benefits, one commenter stated that the increased costs of centrally clearing U.S. Treasury security transactions may reduce liquidity and diversity in the Treasury market if firms reduce activity, leave the market, or if barriers to entry are too high, given the significant costs of clearing for market participants.³⁷ The commenter identified several types of costs, including initial margin requirements, clearing fees, obligations with respect to FICC’s Capped Contingent Liquidity Facility (“CCLF”), the operational build necessary to access central clearing either as a direct or indirect participant, and legal costs and time associated with

³⁵ Letter from William C. Thum, Managing Director and Assistant General Counsel, Securities Industry and Financial Markets Association (“SIFMA”) Asset Management Group, at 7 (Dec. 23, 2022) (“SIFMA AMG Letter”).

³⁶ Additional Information about Reference Rates Administered by the New York Fed, *available at* https://www.newyorkfed.org/markets/reference-rates/additional-information-about-reference-rates#tgcr_bgcr_sofr_calculation_methodology.

³⁷ Letter from Robert Toomey, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, and Michelle Meertens, Deputy General Counsel, Institute of International Bankers, at 8 (Dec. 22, 2022) (“SIFMA/IIB Letter”).

onboarding customers for indirect central clearing, including, *e.g.*, the need for Sponsoring Members to file UCC financing statements with respect to Sponsored Members under the Sponsored Member program. The commenter stated that the impact of these costs would be disproportionately felt by small and mid-sized participants in the U.S. Treasury market, and that these costs would reduce diversity in the market and further increase concentration among market participants (which may increase systemic risk) if such participants leave the market.³⁸

As discussed in more detail in part IV.C.2, increased transaction costs will generally reduce the expected return of a particular investment. If the amendments regarding eligible secondary market transactions resulted only in such increased costs, then the potential risk/return tradeoff would worsen, resulting in decreased transaction volumes and decreased liquidity. However, central clearing provides other benefits, including those described in part IV.C.1, many of which could accrue to small and mid-sized market participants. Moreover, increased cost does not necessarily mean that firms will reduce activity or leave the market.

The commenter also stated that these costs may incentivize non-direct participants of a U.S. Treasury securities CCA to look for ways to trade away from direct participants in order to not have to centrally clear U.S. Treasury transactions, undermining the policy goals of the proposal.³⁹ The Commission acknowledges that the proposed requirement for U.S. Treasury securities CCAs to require their members to submit eligible secondary market transactions for clearing and settlement does not limit the ability of market participants to transact in U.S. Treasury securities transactions away from CCAs. This requirement is not a mandate to clear all transactions in U.S. Treasury securities, regardless of who executes the transaction, and differs from the swaps

³⁸ SIFMA/IIB Letter, *supra* note 37, at 8.

³⁹ SIFMA/IIB Letter, *supra* note 37, at 8.

mandate imposed by Congress in the Dodd-Frank Act in 2010.⁴⁰ However, given current market structure and requirements applicable to certain market participants, it would be challenging for market participants to simply shift all their activity to transact away from CCAs. For example, primary dealers, which serve as trading counterparties of the New York Fed in its implementation of monetary policy, are required to maintain a substantial presence as a market maker that provides two-way liquidity in U.S. government securities, particularly Treasury cash and repo operations.⁴¹ These primary dealers must be participants in FICC, as the CCP for the government securities market, to support clearing of primary market transactions.⁴² Therefore, if a market participant wants to transact with a primary dealer which is required to be a direct participant of FICC, it would have to determine an appropriate way to submit such transactions for clearing and settlement. Primary dealers are responsible for a significant portion of market activity in the U.S. Treasury market (*see* part IV.B *infra*), and therefore, market participants likely would continue to transact with such primary dealers.

In addition, the commenter stated that central clearing can have procyclical effects in times of market stress due to the margin requirements of clearing agencies, further reducing liquidity when it is most needed.⁴³ The commenter stated that, depending on the applicable margin models, clearing can be procyclical in times of market turmoil, as increased margin requirements (including intraday and ad hoc calls) drive demand for liquid assets, which, in turn, increases the scarcity of those assets and further drives market stress. The commenter described FICC's rules as

⁴⁰ Dodd-Frank Act section 723; 15 U.S.C. 3C(a).

⁴¹ *See* Primary Dealers, available at <https://www.newyorkfed.org/markets/primarydealers> (“In order to be eligible as a primary dealer, a firm must . . . Be a participant in the central counterparty service for the government securities market—DTCC’s FICC-GSD—to support clearing of primary market transactions.”).

⁴² *Id.*

⁴³ SIFMA/IIB Letter, *supra* note 37, at 9.

allowing FICC to demand, at any time in its discretion, additional margin from its members in times of market volatility, including through intraday calls, to safeguard the clearing infrastructure.⁴⁴ The commenter suggested that the Commission should engage in additional study on the procyclical effects of central clearing before implementing a central clearing requirement, focusing on the appropriate balance from a systemic risk perspective of rigorously managing the risk of positions cleared through a CCP as compared to minimizing liquidity strains on the U.S. Treasury market.⁴⁵

The Commission acknowledges that, in times of market stress, margin calls may increase to address the ongoing market volatility. This is by design, as margin models are built to be responsive to current market conditions. The Commission has specifically required that CCAs have the authority and operational capacity to make intraday margin calls in defined circumstances.⁴⁶ This ability is important to the CCA's ability to manage the risk and cover the credit exposures that its participants may bring to the CCA. When considering a CCA's authority with respect to intraday margin, the Commission may consider its potential procyclicality.⁴⁷ In addition, the Commission may consider the transparency of the margin model, such that market

⁴⁴ SIFMA/IIB Letter, *supra* note 37, at 9.

⁴⁵ SIFMA/IIB Letter, *supra* note 37, at 9.

⁴⁶ 17 CFR 240.17ad-22(e)(6)(ii).

⁴⁷ *See, e.g.*, Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change to Modify the Calculation of the MBS VaR Floor to Incorporate a Minimum Margin Amount, Exchange Act Release No. 92303, at 32 (June 30, 2021) (discussing commenter's concern regarding potential procyclical nature of a margin methodology change); Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change Concerning The Options Clearing Corporation's Margin Methodology for Incorporating Variations in Implied Volatility, Exchange Act Release No. 95319, at 3 (July 19, 2022) (referencing the impact of a change to margin methodology on procyclicality of margin).

participants can understand when the CCA may make margin calls.⁴⁸ In addition to the FICC rules cited by the commenter, FICC has provided additional transparency regarding how it determines the need for intraday margin calls, including the specific criteria that it uses to assess the need.⁴⁹ FICC is also subject to Rule 17ad-22(e)(23), which requires certain levels of public disclosure regarding FICC's margin methodology and the costs of participating in FICC, as discussed further in part II.B.2 *infra*. The Commission's ongoing consideration of the role and function of intraday margin calls, as well as market participants' ability to understand such calls, obviates the need for separate study in connection with this proposal.⁵⁰

b. Comments Regarding the Concentration of Risk in One Covered Clearing Agency

Commenters also mentioned the potential concentration risk that would arise as a result of the requirement to clear eligible secondary market transactions, specifically because only one

⁴⁸ See, e.g., Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving a Proposed Rule Change to Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs and Make Certain Other Changes to Procedure XV, Exchange Act Release No. 34-90502, at 56-59 (Nov. 24, 2020) (discussing commenter's concerns regarding transparency of change to margin methodology).

⁴⁹ See Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Changes to the Required Fund Deposit Calculation in the Government Securities Division Rulebook, Exchange Act Release No. 82588 (Jan. 26, 2018) (identifying the following specific parameter breaks: (i) a dollar threshold that evaluates whether a Netting Member's Intraday VaR Charge equals or exceeds a set dollar amount (then set at \$1,000,000) when compared to the VaR Charge that was included in the most recently collected Required Fund Deposit including, any subsequently collected Intraday Supplemental Fund Deposit; (ii) a percentage threshold, that evaluates whether the Intraday VaR Charge equals or exceeds a percentage increase (then set at 100%) of the VaR Charge that was included in the most recently collected Required Fund Deposit including, if applicable, any subsequently collected Intraday Supplemental Fund Deposit; (iii) the coverage target, that evaluates whether a Netting Member is experiencing backtesting results below the 99% confidence level). FICC has updated this information via Important Notices to its participants. See, e.g., Important Notice GOV1244-22, GSD Intraday Supplemental Fund Deposit Parameter Change (Apr. 11, 2022), available at <https://www.dtcc.com/-/media/Files/pdf/2022/4/11/GOV1244-22.pdf> (raising the coverage target).

⁵⁰ See also Proposed Rule, Covered Clearing Agency Resilience and Recovery and Wind-Down Plans, Exchange Act Release No. 97516 (May 17, 2023), 88 FR 34708 (May 30, 2023) (proposing additional requirements with respect to intraday margin that CCAs require intraday monitoring of their exposures and specifying particular circumstances in which the CCA should make intraday margin calls).

covered clearing agency currently provides such services. One commenter stated that concentrating such significant levels of settlement, operational, liquidity and credit risk in one institution means that were there operational or liquidity stress at FICC, widespread dysfunction in the Treasury markets could result.⁵¹ Another commenter which analyzed market views of the proposal identified increased concentration risk as a primary concern for market participants, who cited potential technical issues at FICC that would result in a “pause [of] counterparty trade transactions and lead to substantial losses for market participants.” However, the commenter also acknowledged that a smaller group of market participants explained that they were not opposed to a single clearinghouse model through FICC, stating that FICC has adequate risk models and that the concentration in one CCP is not of concern in the futures or derivatives markets, which, like FICC, also only have one CCP to serve their respective markets.⁵²

In addition, one commenter stated that the Commission should only impose a clearing mandate once FICC and at least a second covered clearing agency are able to offer access to clearing solutions that will fulfill the enhanced rule requirements and meet the needs of market participants.⁵³ The commenter noted that the existence of one covered clearing agency serving the U.S. Treasury market is highly problematic as it creates enormous concentration risk for market participants, and highlighted that, given the importance of the U.S. Treasury market to the overall global economy, there needs to be a compelling reason for increasing the concentration of cleared trading activity in a single clearing house that is member owned and operated on a for-profit basis,

⁵¹ SIFMA/IIB Letter, *supra* note 37, at 10.

⁵² Comment Submission from SIA Partners, entitled CENTRAL CLEARING OF U.S. TREASURIES & REPO, A Study on the Impact to the Market and Market Participants, at 79-80 (Mar. 2023) (“SIA Partners Comment”); *see also id.* at 8.

⁵³ SIFMA/AMG Letter, *supra* note 37, at 3, 9.

particularly when there is no alternative or fallback venue should the clearing house experience a disruption to its operations or more significantly were it to fail.⁵⁴

The Commission acknowledges that, currently, there is only one U.S. Treasury securities CCA, FICC, and that this does create concentration risk for the clearing of U.S. Treasury securities transactions. However, this concentration risk is mitigated by the existence of a supervisory framework for the existing U.S. Treasury securities CCA, and it is not uncommon for one CCA to serve a particular market.⁵⁵ The Commission therefore disagrees with the commenter that the existence of two CCAs is necessary for this requirement to be implemented. Moreover, the Commission is not requiring that the additional central clearing of U.S. Treasury securities transactions be concentrated in one clearing house. But, if that remains the case going forward, the benefits expected to arise from this additional clearing, as discussed further in part IV.C.1 *infra*, constitute a sufficient compelling reason to adopt the final rule, even if such concentration is present, which, as discussed, is subject to the appropriate mitigation of risk arising from the regulatory framework applicable to CCAs as discussed in this section.

FICC has been designated by the Financial Stability Oversight Council as systemically important under Title VIII of the Dodd-Frank Act. This designation means that FICC is subject to heightened supervision and examination by the Commission, in consultation with the Board of Governors of the Federal Reserve System (“Board of Governors”). FICC is subject to the Covered Clearing Agency Standards, which address the various types of risk that FICC faces as a CCP, including settlement, operational, liquidity, and credit risk.

⁵⁴ SIFMA/AMG Letter, *supra* note 37, at 9.

⁵⁵ For example, there is only one CCA in the U.S. equities market and in the U.S. listed derivatives market.

A CCA must be able to meet the requirements of the Covered Clearing Agency Standards regardless of the presence or absence of other CCAs. The Covered Clearing Agency Standards specifically address a CCA's obligations in 23 specific areas, many of which directly relate to the CCA's ability to manage the risks presented to it as a CCA. For example, a CCA must have policies and procedures in place to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by, among other things, maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence and maintain additional financial resources to enable it to cover a wide range of foreseeable stress scenarios, including the default of the largest or two largest participant families (depending on the nature of the CCA's activities). A CCA also must have policies and procedures in place to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the CCA, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity, by, among other things, holding qualifying liquid resources in an amount sufficient 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 largest participant family in extreme but plausible market conditions. With respect to both its credit and liquidity resources, the CCA is required to, among other things, test the sufficiency of such resources at least once each day using standard and predetermined parameters and assumptions, conduct a comprehensive analysis on at least a monthly basis of the existing scenarios, models, and underlying parameters and assumptions used to ensure that they are appropriate for determining the CCA's needs and resources in light of

current and evolving market conditions, and to perform a model validation of the models used for such testing at least annually.⁵⁶

In addition, a CCA is required to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum and among other things, calculates margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default, and is monitored by management on an ongoing basis and is regularly reviewed, tested, and verified by conducting backtests of its margin model at least once each day using standard predetermined parameters and assumptions and conducting a sensitivity analysis of its margin model and a review of its parameters and assumptions for backtesting on at least a monthly basis, among other things.⁵⁷ A CCA also is required to have policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis; and identify, monitor, and manage the material risks to the CCA arising from arrangements in which firms that are indirect participants in the CCA rely on the services provided by direct participants to access the CCA's payment, clearing, or settlement facilities.⁵⁸

⁵⁶ 17 CFR 240.17ad-22(e)(4)(vi) and (vii) and (e)(7)(vi) and (vii).

⁵⁷ 17 CFR 240.17ad-22(e)(6).

⁵⁸ 17 CFR 240.17ad-22(e)(18) and (19).

These requirements should ensure that a CCA is able to accommodate the market needs for its clearance and settlement activity and that a CCA can appropriately risk manage the activity that its participants submit for clearing and settlement, which should, in turn, mitigate the potential concentration risk arising from the existence of only one CCA for a particular asset class.

Further, regarding the comments raising concerns about potential operational or technical issues at a single CCA, the Covered Clearing Agency Standards include Rule 17ad-22(e)(17), which requires written policies and procedures reasonably designed to manage the covered clearing agency's operational risks by (i) identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls; (ii) ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity; and (iii) establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations.⁵⁹ In addition, CCAs, as registered clearing agencies, are subject to the requirements of Regulation Systems Compliance Integrity ("Regulation SCI"). Regulation SCI is designed to strengthen the infrastructure of the U.S. securities markets, reduce the occurrence of systems issues in those markets, improve their resiliency when technological issues arise, and implement an updated and formalized regulatory framework, thereby helping to ensure more effective Commission oversight of such systems.⁶⁰ As entities subject to Regulation SCI, CCAs are required to have written policies and procedures reasonably designed to ensure that their key automated systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and that such

⁵⁹ 17 CFR 240.17ad-22(e)(17).

⁶⁰ Securities Exchange Act Release No. 73639 (Nov. 19, 2014), 79 FR 72252, 72253, 72256 (Dec. 5, 2014).

systems operate in accordance with the Exchange Act and the rules and regulations thereunder and the entities' rules and governing documents, as applicable.⁶¹ These requirements should work to mitigate the possibility that a CCA would experience an interruption to its operations. In the event that a CCA were to fail, it is required to have policies and procedures to establish a recovery and wind-down plan to address that situation.⁶²

FICC also must meet its obligations under both Section 19(b) of the Exchange Act, as a self-regulatory organization, and Title VIII of the Dodd-Frank Act. This means that the Commission has the opportunity to review any proposed rule changes and imposes specific additional filing obligations for an entity designated as systemically important under Title VIII of the Dodd-Frank Act to provide advance notice to the Commission, which must consult with the Board of Governors, of any change to the entity's procedures that may materially alter the nature or level of risk presented.⁶³ This overall supervisory framework, including the Covered Clearing Agency Standards, should help ensure that FICC continues to be subject to robust supervision and oversight and to be able to manage the risks presented to it, even those arising from increased Treasury clearing. In light of the robust regulatory framework applicable to CCAs, the fact that only one CCA serves the market should not preclude the imposition of a requirement to clear eligible secondary market transactions.

Further, the Commission is not persuaded that the ownership or organizational structure of the present U.S. Treasury securities CCA has an effect on its ability to serve the market. The

⁶¹ See 17 CFR 242.1001.

⁶² 17 CFR 240.17ad-22(e)(3)(ii). In the event of a wind-down in which the result is that the U.S. Treasury securities CCA no longer exists, Rule 17ad-22(e)(18)(iv) would not apply, as there would be no CCA to impose such membership requirements. The requirement to clear eligible secondary market transactions arises under the CCA's rules and is not a mandate to clear based on the nature of the security.

⁶³ 12 U.S.C. 5465(e); 17 CFR 240.19b-4.

Commission has not imposed particular requirements for the ownership or corporate structure of CCAs, and CCAs currently exhibit a variety of ownership and corporate structures. For example, FICC is wholly owned by the Depository Trust & Clearing Corporation (“DTCC”), which is, in turn, owned by the members of the clearing agencies owned by the DTCC.⁶⁴ FICC operates on a cost plus low-margin model, meaning that its fees are cost-based plus a markup as approved by the Board or management and that this markup or “low margin” is applied to recover development costs and operating expenses and to accumulate capital sufficient to meet regulatory and economic requirements.⁶⁵ Nevertheless, a CCA’s status as a for-profit organization does not preclude its ability to meet its requirements under the Covered Clearing Agency Standards.

An additional commenter stated its belief that relinquishing control of credit approval to a single entity poses a significant problem, particularly, with all transactions going through FICC and where margin requirements can be changed at any time. The commenter stated that every firm has a different risk appetite and quantitative and qualitative perspectives as it relates to credit analysis, which are part of the professional services and expertise that well-run firms offer, and that by inserting FICC into the center of the credit approval process, firms lose their ability to apply their deeply informed market views and differentiate themselves from competitors.⁶⁶

⁶⁴ The members of such clearing agencies are required to purchase common shares under DTCC’s Shareholders Agreement as a condition to use the clearing agencies’ services and facilities. *See, e.g.*, FICC Rule 49, section 2, *supra* note 19. This differs from other clearing agencies or clearing organizations in which the shareholders are not limited to the participants of the clearing agency and the clearing agency may be owned by a publicly traded company.

⁶⁵ *See, e.g.*, Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Certain MBSD Fees, Exchange Act Release No. 96575 (Dec. 22, 2022). In addition, because FICC is member-owned, members may receive rebates when FICC collects excess net income, which is defined as either income of FICC or one business line of FICC after application of expenses, capitalization costs, and applicable regulatory requirements. *See* FICC Rules, Fee Structure, Section XII, *supra* note 19.

⁶⁶ Letter from the Independent Dealer & Trader Association, at 9 (Dec. 27, 2022) (“IDTA Letter”).

The Commission disagrees that the requirement to clear eligible secondary market transactions, which currently can be done only at FICC, will remove firms' ability to differentiate themselves from their competitors. FICC has no role in the relationship between a direct participant and the direct participant's customers, and, indeed, the Exchange Act provides that its rules cannot impose any schedule of prices, or fix rates or other fees, for its participants' services.⁶⁷ FICC's direct participants will remain free to determine what services they will offer to their customers, and at what price, thereby providing the ability for the direct participants to differentiate themselves from their competitors.

The Commission also disagrees that margin requirements at FICC can change at any time. FICC's margin methodology is part of its rules that have been approved by the Commission, and changes to that methodology must be filed with and reviewed by the Commission because of FICC's status as a self-regulatory organization. The margin methodology, which is part of FICC's approved rules, does provide some flexibility to FICC to manage risk, and potentially increase margin requirements, in times of market volatility and to guard against exposure to the CCP, but this flexibility is not equivalent to FICC being able to alter its margin requirements at any time. Pursuant to the Commission's rules, FICC would be obligated to file for Commission review any proposed change to its margin methodology and to file an advance notice of any proposed change to its rules in the event that the change would materially alter the nature or level of risk presented by the CCA, with both of these processes involving notice and the opportunity for public comment.⁶⁸

⁶⁷ 15 U.S.C. 78q-1(b)(3)(E).

⁶⁸ 15 U.S.C. 78s(b); Dodd-Frank Act Section 806(e); 17 C.F.R. 240.19b-4.

Finally, one commenter also stated that any final rule should expressly acknowledge the potential for multiple U.S. Treasury securities CCAs and prohibit a clearing agency's rules from restricting or impeding in any way their members' ability to clear U.S. Treasury securities cash or repo transactions at another CCA.⁶⁹ Such clarification is unnecessary. The requirements being adopted apply to any U.S. Treasury securities CCA and do not rely on the existence of only one U.S. Treasury securities CCA. The Commission acknowledges that there is the potential for multiple clearing agencies serving the U.S. Treasury market under its regulatory framework, and that the existence of additional U.S. Treasury securities CCAs would lower the concentration risk that currently exists due to having a single CCA for that market. Moreover, a rule prohibiting a clearing agency from restricting or impeding in any way its member's ability to clear at another CCA is also unnecessary because to be registered under Section 17A of the Exchange Act, a clearing agency's rules must not impose any burden on competition not necessary or appropriate in furtherance of the purposes of Section 17A.⁷⁰

c. Final Rule

For the reasons discussed in parts II.A.1.a and b *supra*, the Commission is adopting Rule 17ad-22(e)(18)(iv) as proposed.⁷¹ This requirement applies to all types of transactions that are of a type currently accepted for clearing at a U.S. Treasury securities CCA; it does not impose a requirement on a U.S. Treasury securities CCA to offer additional products for clearing.

⁶⁹ ICE Letter, *supra* note 33, at 2-3.

⁷⁰ 15 U.S.C. 78q-1(b)(3)(I).

⁷¹ The Commission also amends the CFR designation of Rule 17Ad-22 in order to ensure the regulatory text conforms more consistently with section 2.13 of the Document Drafting Handbook. See Office of the Federal Register, Document Drafting Handbook (Aug. 2018 Edition, Revision 2.1, dated Oct. 2023), *available at* <https://www.archives.gov/files/federal-register/write/handbook/ddh.pdf>. In particular, the Commission amends the CFR section designation for 17 CFR 240.17Ad-22 (Rule 17Ad-22) to replace the uppercase letter with the corresponding lowercase letter, such that the rule is redesignated as 17 CFR 240.17ad-22 (Rule 17ad-22).

2. Definition of Eligible Secondary Market Transactions

As part of Rule 17ad-22(a), the Proposing Release set forth a definition of an eligible secondary market transaction in U.S. Treasury securities⁷² subject to the requirement to submit for clearance and settlement discussed in part II.A.1 above. Specifically, the definition of an eligible secondary market transaction⁷³ would include:

- Repurchase agreements and reverse repurchase agreements in which one of the counterparties is a direct participant;
- Any purchases and sales entered into by a direct participant if the direct participant (A) brings together multiple buyers and sellers using a trading facility (such as a limit order book) and (B) is a counterparty to both the buyer and seller in two separate transactions; and
- Any purchases and sales of U.S. Treasury securities between a direct participant and a counterparty that is a registered broker-dealer, government securities dealer, or government securities broker, a hedge fund, or an account at a registered broker-dealer, government securities dealer, or government securities broker where such account may borrow an amount in excess of one-half of the value of the account or may have gross notional exposure of the transactions in the account that is more than twice the value of the account.

⁷² The Commission did not receive any comments on its proposed definition of “U.S. Treasury security” and is adopting that definition as proposed.

⁷³ As the Commission stated in the Proposing Release, the amendment does not apply to the primary market, *i.e.*, the issuance and sale of a U.S. Treasury security to a primary dealer or other bidder in a U.S. Treasury auction. Proposing Release, *supra* note 14, 87 FR at 64621. Further, as the Commission also stated in the Proposing Release, because trading in when-issued securities occurring the day after the auction shares similar characteristics to secondary market transactions and because such trading is already reported as a secondary market transaction, the definition of an eligible secondary market transaction would apply to when-issued trades that occur the day after the auction and are considered on-the-run on some IDBs, to the extent that such when-issued trades otherwise meet the definition of an eligible secondary market transaction, as discussed further in part II.A.2.ii *infra*. *Id.* However, because when-issued trading occurring before and on the day of the auction does not share these characteristics and is primarily used as a tool for price discovery leading to the auction, such transactions would not be encompassed by the definition. *Id.*

The Commission is adopting this rule, with modifications related to repos by other clearing organizations (*see* part II.A.2.a.iii), inter-affiliate repo transactions (*see* part II.A.2.a.vi), and state and local government repo transactions (*see* part II.A.2.a.vii) and related to cash transactions by hedge funds and leveraged accounts (*see* part II.A.2.b.iii). The Commission discusses the proposed definitions and the comments received thereupon in the following sections.

a. Repo Transactions

The proposed definition of an eligible secondary market transaction would include, among other things, all U.S. Treasury repurchase and reverse repurchase agreements entered into by a direct participant of a U.S. Treasury securities CCA, subject to the exclusions discussed in part XX *infra*. As explained in the Proposing Release, in a U.S. Treasury repo transaction, one party sells a U.S. Treasury security to another party (often referred to as the “start leg”) and commits to repurchase the security at a specified price on a specified later date (often referred to as the “end leg”), and a reverse repo transaction is the same transaction from the buyer’s perspective.⁷⁴

In the Proposing Release, the Commission stated that the available data indicates that the volume of repo transactions that are bilaterally cleared and settled remains substantial.⁷⁵ Because

⁷⁴ Proposing Release, *supra* note 14, 87 FR at 64616. The effect of a repo transaction is similar to a cash loan, using U.S. Treasury securities as collateral. *Id.* However, standard industry documentation classifies the start and end legs of the repo transaction as purchases and sales of securities. *See, e.g.,* SIFMA, *Master Repurchase Agreement (September 1996 Version)*, available at https://www.sifma.org/wp-content/uploads/2017/08/MRA_Agreement.pdf. In this release, the term “seller” refers to the party selling U.S. Treasury securities on the start leg of the transaction and repurchasing them on the end leg of the transaction. The term “buyer” refers to the party purchasing the U.S. Treasury securities on the start leg of the transaction and selling them on the end leg of the transaction.

⁷⁵ Proposing Release, *supra* note 14, 87 FR at 64616 (citing 2021 IAWG Report, *supra* note 4, at 29 (stating that non-centrally cleared bilateral repo represents a significant portion of the market, roughly equal in size to centrally cleared repo) (citing a 2015 pilot program by the Treasury Department); TMPG, *Clearing and Settlement Practices for Treasury Secured Financing Transactions Working Group Update* (“TMPG Repo White Paper”), at 1 (Nov. 5, 2021), available at https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CSP_SFT_Note.pdf; Katy Burne, “Future Proofing the Treasury Market,” BNY Mellon Aerial View, at 7 (Nov. 2021), available at <https://www.bnymellon.com/content/dam/bnymellon/documents/pdf/aerial-view/future-proofing-the-us->

of this, FICC lacks visibility into its members' non-centrally cleared repo trades, and the default of one counterparty can have cascading effects on multiple other market participants, including members of FICC, thereby risking contagion to the CCP.

The Commission also stated its belief that, particularly with respect to banks and dealers, an important potential benefit of repo central clearing stems from mitigating the constraints on intermediaries' balance sheets under the existing accounting and regulatory capital rules.⁷⁶ The Commission further stated that it believes that the benefit of this resulting additional balance sheet capacity could be shared by all market participants through improved market liquidity and smooth market functioning.⁷⁷

The Commission also referenced that, as with cash markets, risk management practices in the bilateral clearance and settlement of repos are not uniform across market participants and are not transparent.⁷⁸ Indeed, a recent publication stated that competitive pressures in the bilaterally settled market for repo transactions have exerted downward pressure on haircuts, sometimes to

[treasury-market.pdf.coredownload.pdf](#) (noting that 63% of repo transactions remain non-centrally cleared according to Office of Financial Research data as of Sept. 10, 2021); Sebastian Infante *et al.*, *Insights from revised Form FR2004 into primary dealer securities financing and MBS activity* (Aug. 5, 2022), available at <https://www.federalreserve.gov/econres/notes/feds-notes/insights-from-revised-form-fr2004-into-primary-dealer-securities-financing-and-mbs-activity-20220805.htm> (recent research with respect to primary dealers indicates that 38% of their repo and 60% of their reverse repo activity is not centrally cleared, and, overall, that 20% of all their repo and 30% of their reverse repo activity is centrally cleared through FICC)).

⁷⁶ In effect, accounting rules allow purchases and sales of the same security to be netted but do not allow repos of the same security to be netted, unless the repos are with the same counterparty and the trades have been documented under a master netting agreement. *See, e.g.*, Proposing Release, *supra* note 14, 87 FR at [xx] (citing G-30 Report, *supra* note 5, at 13; Program on International Financial Systems, *Mandatory Central Clearing for U.S. Treasuries and U.S. Treasury Repos*, at 25-27 (Nov. 2021), available at <https://www.pifsinternational.org/wp-content/uploads/2021/11/PIFS-Mandatory-Central-Clearing-for-U.S.-Treasury-Markets-11.11.2021.pdf> ("PIFS Paper")). Thus, if a dealer's repos are all with a U.S. Treasury securities CCA, greater netting is allowed.

⁷⁷ *See* Committee on the Global Financial System, *Repo Market Functioning*, at 24 (Apr. 2017), available at <https://www.bis.org/publ/cgfs59.pdf>.

⁷⁸ TMPG Repo White Paper, *supra* note 75, at 1.

zero.⁷⁹ The reduction of haircuts, which serve as a counterparty credit risk mitigant in bilateral repos, could result in greater exposure to potential counterparty default risk in non-centrally cleared repos. The Commission stated that by contrast, a U.S. Treasury securities CCA is subject to the Commission’s risk management requirements addressing financial, operational, and legal risk management, which include, among other things, margin requirements commensurate with the risks and particular attributes of each relevant product, portfolio, and market.⁸⁰ Therefore, repos cleared at a U.S. Treasury securities CCA would be subject to transparent risk management standards that are publicly available and applied uniformly and objectively to all participants in the CCA.

Many commenters supported the definition of an eligible secondary market transaction as it relates to repo and reverse repo transactions.⁸¹ These commenters encouraged a broad and comprehensive definition to limit market fragmentation and avoidance of central clearing. Several other commenters that did not support a requirement to clear eligible secondary market

⁷⁹ G-30 Report, *supra* note 5, at 13.

⁸⁰ 17 CFR 240.17ad-22(e)(6).

⁸¹ See Letter from Jiri Król, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Association, at 6-7 (Dec. 22, 2022) (“AIMA Letter”); AFREF Letter, *supra* note 33, at 3; *see generally* Better Markets Letter, *supra* note 33; DTCC/FICC Letter, note 33; Letter from Ryan Sheftel, Global Head of Fixed Income, GTS Securities, LLC (Jan. 6, 2023) (“GTS Securities Letter”); LSEG Letter, *supra* note 33; Letter from ARB Trading Group LP, Citadel Securities, DRW Holdings, LLC, Eagle Seven LLC, Geneva Trading USA, LLC, Hard Eight Futures, LLC, Hudson River Trading LLC, IMC Trading, Jump Trading Group, Kore Trading LLC, Optiver, Quantlab Financial, LLC, WH Trading LLC, and XR Trading LLC, at 4 (Dec. 27, 2022) (“ARB et al. Letter”); Letter from Manfred E. Will, Founder & CEO, MEW Consul (Oct. 24, 2022); Letter from Shiv Rao, Chairman, Sunthay Holdings LLC, at 2 (Dec. 27, 2022); and Letter from Elisabeth Kirby, Head of U.S. Market Structure, Tradeweb Markets Inc. (Dec. 27, 2022). One commenter, while broadly supporting the definition of an eligible secondary market repo and reverse repo transaction, recommended excluding Derivatives Clearing Organizations (“DCO”) registered with the CFTC. See Letter from Jonathan Marcus, Senior Managing Director and General Counsel, CME Group Inc., at 6-7 (Dec. 27, 2022) (“CME Letter”) and part II.A.2.iii *infra*. Other commenters, while broadly supporting the definition, recommended excluding transactions executed on the triparty repo platform. See Letter from Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel and Citadel Securities (Dec. 27, 2022) (“Citadel Letter”), Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association at 6, 14 (Dec. 21, 2022) (“MFA Letter”), and part II.A.2.i *infra*.

transactions still acknowledged that repos were the most appropriate scope for such a requirement if one were to be adopted. For example, one commenter agreed that a clearing mandate applied to bilateral repo transactions would be beneficial, pointing to the balance sheet efficiency resulting from repo clearing, but stressing that this requirement be put in place only after the Commission has strengthened the ability for market participants to access central clearing.⁸² Another commenter stated that while the case for clearing repos is “marginally stronger” than the case for clearing cash transactions, it is “far from convincing.”⁸³

Other commenters questioned the need for a requirement with respect to repo, noting that the balance sheet netting efficiencies already exist, providing a natural incentive to centrally clear such transactions.⁸⁴ The Commission agrees that centrally cleared repo already benefits from favorable treatment on balance sheet, but also recognizes that, by definition, a requirement to clear repo transactions should result in more transactions being centrally cleared. Thus, there would still be benefits from the requirement, despite the currently existing balance sheet treatment, as discussed further in part IV.C.1.a.ii.

In addition, some commenters supported excluding particular types of repos from the definition, and other commenters supported excluding particular types of market participants engaging in repos from the definition. The Commission discusses these comments in the following parts.

⁸² MFA Letter, *supra* note 81, at 13 (supporting inclusion of bilateral repo and reverse repo).

⁸³ SIFMA AMG Letter, *supra* note 35, at 11.

⁸⁴ *See, e.g.*, SIFMA AMG Letter, *supra* note 35, at 4; SIFMA-IIB Letter, *supra* note 37, at 4.

i. Triparty Repo

Several commenters supported excluding triparty repos from the definition of an eligible secondary market transaction.⁸⁵ One commenter suggested that the cost of including triparty repos would outweigh the benefits, and other commenters raised similar concerns.⁸⁶ The discussion of additional costs and benefits arising from the inclusion of triparty repos within the definition of an eligible secondary market transaction is provided in part IV.C.2 *infra*. Several commenters argued that including triparty repos would not significantly reduce the risks that the proposal seeks to address because the current triparty market infrastructure inherently mitigates the associated risks.⁸⁷ Specifically, these commenters argue that credit risk in the triparty market is mitigated by the triparty agent's provision of custodial, collateral management, and settlement services.⁸⁸

Moreover, one commenter stated that the infrastructure underlying the triparty repo market is robust and provides credit protections, operational safeguards, and strict internal controls akin to central clearing.⁸⁹ One commenter stated that the triparty agent's ability to handle the settlement of triparty repos through its collateral allocation system has resulted in a well-functioning process that operates under severe time constraints.⁹⁰ One commenter added that the triparty market is

⁸⁵ See MFA Letter, *supra* note 81, at 6, 14; SIFMA-IIB Letter, *supra* note 37, at 20-21; SIFMA AMG Letter, *supra* note 35, at 6, 11; Letter from Sarah A. Bessin, Deputy General Counsel, and Nhan Nguyen, Assistant General Counsel, Investment Company Institute at 22-23 (Dec. 23, 2022) ("ICI Letter"); Citadel Letter, *supra* note 81, at 6; Letter from Deborah A. Cunningham, Executive Vice President, Chief Investment Officer of Global Liquidity Markets, and Senior Portfolio Manager, Susan R. Hill, Senior Vice President, Senior Portfolio Manager and Head of Government Liquidity, and David R. McCandless, Corporate Counsel, Federated Hermes at 5 (Dec. 28, 2022) ("Federated Letter"); Letter from Sebastian Crapanzano, Managing Director, Morgan Stanley, at 2 (Nov. 15, 2023) ("Morgan Stanley Letter").

⁸⁶ See MFA Letter, *supra* note 81, at 6, 14; *see also* SIFMA/IIB Letter, *supra* note 37, at 20; ICI Letter, *supra* note 85, at 11; Federated Letter, *supra* note 85, at 5.

⁸⁷ See MFA Letter, *supra* note 81, at 14; SIFMA/AMG Letter, *supra* note 35, at 11; ICI Letter, *supra* note 85, at 12, 22; Citadel Letter, *supra* note 81, at 6; Federated Letter, *supra* note 85, at 5.

⁸⁸ *See id.*

⁸⁹ *See* ICI Letter, *supra* note 85, at 22.

⁹⁰ *See* Federated Letter, *supra* note 85, at 3.

relatively safe from credit risk because the triparty agent is subject to prudential regulation.⁹¹ One commenter added that settlement risk in the triparty market is nearly eliminated because collateral posted to the triparty platform cannot generally be repledged outside the platform.⁹² The commenter stated, therefore, that the only significant source of settlement risk is the rare occurrence of a counterparty's nonpayment of the repurchase price, which is generally attributable to operational risk as opposed to credit risk.⁹³ Another commenter stated that these types of triparty repos, described as secured funding transactions where the funding counterparty has no rehypothecation rights, do not appear to raise concerns discussed in the proposal regarding the use of transactions to generate leverage that would warrant imposition of the requirement to clear eligible secondary market transactions.⁹⁴

Despite supporting the exclusion of triparty repos from the definition of an eligible secondary market transaction, one commenter acknowledged that the triparty agent “does not fulfill a CCP role—it does not guarantee either counterparty’s performance through novation or otherwise and does not assume counterparty risk.”⁹⁵ For this reason, triparty repos will not be excluded from the definition of an eligible secondary market transaction.

The Commission recognizes that the current triparty market infrastructure incorporates credit protections, operational safeguards, and strict internal controls. The Commission also recognizes that the triparty agent’s current processes for handling the settlement of triparty repos generally function well. However, the triparty agent does not serve as a central counterparty,

⁹¹ See MFA Letter, *supra* note 81, at 14.

⁹² See Federated Letter, *supra* note 85, at 5.

⁹³ See Federated Letter, *supra* note 85, at 5.

⁹⁴ Morgan Stanley Letter, *supra* note 85, at 2.

⁹⁵ ICI Letter, *supra* note 85, at 33.

meaning that it does not guarantee either counterparty's performance through novation or assume counterparty risk, and therefore, the Commission disagrees with the contention that the current market infrastructure incorporates controls equivalent to those available through central clearing. The Commission recognizes that the triparty agent is subject to heightened prudential regulation.⁹⁶ However, the triparty agent is not subject to regulatory supervision as a CCP, which entails additional protections against the risk of many market participants acting to liquidate similar collateral in the event of a default in a non-centrally cleared environment. A U.S. Treasury securities CCA is subject to the Commission's risk management requirements addressing financial, operational, and legal risk management, which include, among other things, margin requirements commensurate with the risks and particular attributes of each relevant product, portfolio, and market and also include certain requirements applicable only to covered clearing agencies that are serving as central counterparties.⁹⁷ In contrast, a triparty agent is not equipped with a mechanism to manage the risk of collateral fire-sale in the aftermath of a counterparty default.⁹⁸ As a result, a U.S. Treasury securities CCA is better positioned to handle a large, unexpected default than a triparty agent. The possibility that a direct participant in a U.S. Treasury securities CCA with large, unsettled trading volumes (bilateral or triparty) could fail creates contagion risk to the CCA, as well as to the market as a whole. This rulemaking is designed to ameliorate that contagion risk, at least in part. Accordingly, the Commission does not believe that the current triparty market

⁹⁶ The triparty agent is supervised and/or regulated by, among others, New York State Department of Financial Services, and the Federal Reserve Bank of New York. *See* <https://www.bnymellon.com/us/en/disclaimers/business-disclaimers>. Additionally, the triparty agent is designated as a Global Systemically Important Bank by the Financial Stability Board. *See* <https://www.fsb.org/wp-content/uploads/P211122.pdf>.

⁹⁷ 17 CFR 240.17ad-22(e)(6).

⁹⁸ *See, e.g.*, Brian Begalle et al., The Risk of Fire Sales in the Tri-Party Repo Market, N.Y. Fed Staff Report No. 616 ("Begalle et al."), at 9-14, *available at*, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr616.pdf.

infrastructure alone mitigates the aforementioned contagion risk sufficiently to warrant excluding triparty repos from the definition of an eligible secondary market transaction. In response to the commenter who stated that most risks are eliminated because collateral cannot be posted outside the triparty platform, the Commission disagrees. Significant risks exist if concerns emerge regarding the financial condition of sellers in the triparty market.⁹⁹ In such scenarios, even though collateral stays within the triparty platform, the buyer could still experience distress following a sudden default of a triparty repo counterparty.¹⁰⁰ For example, a triparty repo default may leave a money market fund holding long-dated Treasury securities collateral, which may cause the money market fund to no longer meet requirements under rule 2a-7 relating to the weighted average life to maturity of the fund's portfolio.¹⁰¹ A spike in market volatility accompanying an event of default and potential collateral liquidation activity by buyers could cause liquidity stress for the financial system leading to decline in collateral value even for the most creditworthy assets such as U.S. Treasury securities. A U.S. Treasury securities CCA is better positioned to manage a repo counterparty default by employing a range of available pre-funded resources without reliance on repo collateral liquidation.¹⁰² In contrast, the triparty platform is not designed to manage risks

⁹⁹ See 2013 Annual Report of the Financial Stability Oversight Council, at 4, 12-13, 133-134, *available at* <https://home.treasury.gov/system/files/261/FSOC-2013-Annual-Report.pdf> ("FSOC 2013 Annual Report"); Begalle et al., *supra* note 98 (discussing concern that stress caused by a potential default of a triparty repo counterparty can lead to either pre-default fire sales of assets by the counterparty or post-default fire sales of collateral by the triparty repo investor and the related financial stability concerns). See also 2019 Annual Report of the Financial Stability Oversight Council, at 11, *available at* <https://home.treasury.gov/system/files/261/FSOC2019AnnualReport.pdf> (highlighting that the possibility of fire sales of collateral by creditors of a defaulted counterparty in the triparty repo market remains a financial system vulnerability despite the triparty repo infrastructure reform).

¹⁰⁰ See FSOC 2013 Annual Report, *supra* note 99, at 12-13 (recognizing that a major broker-dealer's default could threaten financial stability as the broker-dealers' creditors liquidate the collateral pledged against their tri-party repo lending, with the fire sales of this collateral potentially destabilizing financial markets and amplifying the negative consequences of such a default).

¹⁰¹ See 17 CFR 270.2a-7(d)(1). In addition, the money market fund holding the collateral may cause liquidity concerns under rule 2a-7. See 17 CFR 270.2a-7(d)(4).

¹⁰² 17 CFR 240.17ad-22(e)(13).

associated with a repo counterparty default and a potential collateral liquidation following the default. In a triparty repo transaction, the triparty custodian bank holds the collateral on behalf of the buyer. However, the buyer is responsible for initiating and managing the collateral liquidation process, including Treasury securities, if the liquidation is necessary.¹⁰³

One commenter argued that including triparty repos in the definition of an eligible secondary market transaction would likely impair the cash and collateral management processes of hedge funds and alternative asset managers.¹⁰⁴ Specifically, the commenter suggested that such firms currently conduct same-day bilateral transactions that they would not be able to conduct with a direct participant of a U.S. Treasury securities CCA required to centrally clear its repo transactions.¹⁰⁵ Similarly, another commenter argued that including triparty repos would prevent participants, such as money market funds, from conducting transactions on a short term (*i.e.*, overnight) basis when U.S. Treasury securities CCAs are at full capacity.¹⁰⁶

The Commission disagrees with these commenters. In its supervisory capacity, the Commission is aware that registered funds, hedge funds, and alternative asset managers currently conduct centrally cleared triparty repo transactions. For example, the Commission is aware that numerous hedge funds conduct such same-day transactions as sponsored members of FICC. Therefore, the existing operational infrastructure supports centrally cleared triparty repo transactions. The FICC novation window for all delivery-versus-payment trades, including the sponsored repo service, remains open until 8 p.m. (ET) and therefore is available for a later-day

¹⁰³ Baklanova, *et al.*, Reference Guide to U.S. Repo and Securities Lending Markets, OFR Working Paper No15-17 (Sept. 2015), available at: <https://www.financialresearch.gov/working-papers/files/OFRwp-2015-17-Reference-Guide-to-U.S.-Repo-and-Securities-Lending-Markets.pdf>.

¹⁰⁴ See MFA Letter, *supra* note 81, at 17.

¹⁰⁵ See *id.*

¹⁰⁶ See ICI Letter, *supra* note 85, at 12, 22.

trading.¹⁰⁷ Additionally, the Commission disagrees that there is a finite “full capacity” at a U.S. Treasury securities CCA. The Commission understands that increased demand for a CCA service may lead to a higher volume of trading activity by existing members and, in certain circumstances, reduce members’ ability or willingness to facilitate their clients’ access to central clearing, if such members do not wish to grow this line of business. However, higher demand for access to central clearing could also present an opportunity for dealers that do not currently offer such services to enter the market, resulting in growing CCA capacity, more competition among its members, and a wider range of available repo counterparties. The Commission also understands that the existing U.S. Treasury securities CCA may consider, as appropriate, additional changes to their operational infrastructure and trading capacity, including revisions to the eligibility criteria for sponsored membership and an extension of the trade submission and novation windows later in the day,¹⁰⁸ to enhance their ability to accommodate any increase in the volume of centrally cleared triparty repo transactions resulting from this rulemaking.

One commenter expressed concern that the centrally cleared triparty repo market has only been available since 2021 and is therefore, relatively untested.¹⁰⁹ Therefore, the commenter suggested that the Commission should delay its decision whether to include triparty repos in the definition of an eligible secondary market transaction until after the Commission has had an opportunity to evaluate the effectiveness of the centrally cleared triparty repo infrastructure.¹¹⁰ The Commission disagrees. While FICC expanded its Sponsored Service in 2021 to enable

¹⁰⁷ See DTCC, Looking to the Horizon: Assessing a Potential Expansion of U.S. Treasury Central Clearing, Sept. 2023 (“DTCC 2023 White Paper”), *available at* <https://www.dtcc.com/-/media/Files/Downloads/WhitePapers/Assessing-Potential-Expansion-US-Treasury-Clearing-White-Paper.pdf>.

¹⁰⁸ *Id.*

¹⁰⁹ See MFA Letter, *supra* note 81, at 12, 14.

¹¹⁰ See *id.*

sponsored members (*e.g.*, registered funds) to conduct centrally cleared triparty repo transactions,¹¹¹ FICC has been facilitating such transactions for its direct participants via the General Collateral Finance (“GCF”) Repo Service since 1998.¹¹² Additionally, although the expanded Sponsored Service is relatively new, the infrastructure is operational, and its usage appears to be increasing. Data provided by the Federal Reserve show a significant increase in the gross value of Treasury securities traded in GCF Repo since March 2020.¹¹³ Additionally, as stated above, the Commission understands that the U.S. Treasury securities CCA is consulting with market participants and is considering steps to further enhance its operational infrastructure to support any increase in the volume of centrally cleared triparty repo transactions resulting from this rulemaking.¹¹⁴

Finally, commenters argued for the exclusion from the definition of an eligible secondary market transaction of triparty repos involving purchased securities that include both Treasury CUSIPs and securities with other CUSIPs or where permitted substitution may be made in CUSIPs other than Treasury CUSIPs. According to the commenters, the fact that some CUSIPs in a mixed triparty repo are U.S. Treasury security CUSIPs should not bring that transaction into the definition of an eligible secondary market transaction if it were of a type that is entered into in the ordinary course of business or otherwise in connection with a legitimate business purpose. The commenters stated that without such an exemption, the definition of an eligible secondary market

¹¹¹ Securities Exchange Act Release No. 92799 (Aug. 27, 2021), 86 FR 49387 (Sept. 2, 2021) (SR-FICC-2021-801); Securities Exchange Act Release No. 92014 (May 25, 2021), 86 FR 29334 (June 1, 2021) (SR-FICC-2021-003).

¹¹² Securities Exchange Act Release No. 40623 (Oct. 30, 1998), 63 FR 59831 (Nov. 5, 1998) (SR-GSCC-98-02).

¹¹³ Federal Reserve, GCF Repo (showing that the daily snapshot of the Treasury securities value traded in the GCF repo segment was under \$120 billion on Mar. 10, 2020. The value reported on June 9, 2023 was over \$320 billion, which includes sponsored activity), *available at* <https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo#interactive/tripartygcf>.

¹¹⁴ See DTCC 2023 White Paper, *supra* note 107.

transaction could scope in transactions of which U.S. Treasury securities only represent a small component, which would exceed the regulatory objective behind the proposal, and stated that such transactions do have margin collected.¹¹⁵

The Commission understands that market participants may use U.S. Treasury securities as permissible substitutions for other types of collateral and generally should not consider mixed CUSIP triparty repos resulting from such a permissible substitution as within the scope of part (i) of the definition of an eligible secondary market transaction. Collateral substitution allows a repo seller to complete trade settlement even if the type of collateral securities agreed upon at the time of trade initiation is no longer available. Typically, Treasury securities or cash can be permissible substitution.¹¹⁶ However, to the extent that a mixed CUSIP triparty repo contains U.S. Treasury CUSIPs from the outset of the transaction, such a transaction would be included in the scope of part (i) of the definition of an eligible secondary market transaction. An exclusion for such transactions is not necessary because the counterparties specifically structured the transaction to include U.S. Treasury securities; therefore, such a transaction is within the scope of the definition. Data submitted by money market funds on Form N-MFP shows that the holdings reported as U.S. Government Agency Repurchase Agreements are typically collateralized by U.S. government agency securities and are also partially collateralized by Treasury securities.¹¹⁷ Collateral

¹¹⁵ See SIFMA/IIB Letter, *supra* note 37, at 20-21; Letter from Jiri Krol, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Association (Oct. 20, 2023) at 3 (“AIMA Letter II”); *see also* Citadel Letter, *supra* note 81, at 6 (supporting that the Commission exclude triparty repos at this stage, noting that they may include both Treasury and non-Treasury securities as collateral).

¹¹⁶ For example, money market fund filings of portfolio data show that, on average, Treasury securities account for around 3% of collateral backing investments in non-government repos.

¹¹⁷ Money market fund filings of portfolio data show that, on average, Treasury securities account for around 20% of collateral backing investments in U.S. government agency repos.

management practices may evolve to better delineate collateral types in light of the definition of an eligible secondary market transaction.

ii. Repos by Registered Funds

Registered investment companies, or registered funds, that is, those entities that are registered under the Investment Company Act of 1940 (“1940 Act”), including money market funds and exchange-traded funds, are important participants in the U.S. Treasury repo market. Filings of Form N-MFP by money market funds show that, as of September 30, 2023, these funds invested approximately \$2.2 trillion in Treasury repos.¹¹⁸ In addition, mutual funds invested \$37 billion in repurchase agreements, including those backed by Treasury securities.¹¹⁹ Generally, commenters acknowledged that central clearing of Treasury repos and reverse repos through the FICC Sponsored Service, which has been available to registered funds since 2005, provides additional collateral supply.¹²⁰ FICC data shows that at the end of November 2023, the daily volume of sponsored “delivery-versus-payment” Treasury repo activity was approximately \$820 billion, while the daily volume of sponsored activity in the triparty GCF repo was close to \$130 billion.¹²¹

Several commenters stated that they did not support including repo transactions with registered funds as a counterparty in the definition of an eligible secondary market transaction,

¹¹⁸ Of this amount, approximately \$1.5 trillion was invested in the Federal Reserve’s overnight reverse repo facility. *See* U.S. Securities and Exchange Commission, Money Market Fund Statistics (Sept. 2023), *available at* <https://www.sec.gov/divisions/investment/mmf-statistics>. Repo transactions with the central bank are excluded from the scope of Eligible Secondary Market Transactions.

¹¹⁹ Federal Reserve, Financial Accounts of the United States, Table L.207 Federal Funds and Security Repurchase Agreements (2023 Q2).

¹²⁰ ICI Letter, *supra* note 85, at 13; Federated Letter, *supra* note 85, at 2; DTCC/FICC Letter, *supra* note 33, at 17.

¹²¹ *See* DTCC, Sponsored DVP and Sponsored GC Activity, *available at* <https://www.dtcc.com/charts/membership>, which also shows data over a longer timeframe for reference.

which, as proposed, would include repo transactions with all counterparties.¹²² One commenter stated that the Commission should not, at this time, require that repos between a fund and a direct participant of a U.S. Treasury securities CCA be subject to a clearing requirement because the current clearing framework is not sufficiently developed to support such a mandate.¹²³ The commenter identified several issues to be addressed prior to adopting such a requirement, which are discussed in the following paragraphs.

First, the commenter stated that the Commission should encourage FICC to enhance its Sponsored Service in several ways, to address regulatory, structural, and operational issues raised by the proposal. The commenter stated that the Commission should encourage FICC to further develop a “give up” structure to facilitate best execution. The commenter described this as a “critically important step” to incentivize voluntary clearing, because it would generate increased competition among market participants, which may result in more efficient pricing. The commenter also stated that a “give up” structure would be essential under a requirement to centrally clear eligible secondary market transactions because the Sponsored Service may not be able to meet the increased capacity requirements due to the limited number of sponsoring members and the increased demand for sponsored clearing under such a requirement. The commenter suggested that the infrastructure currently used by FICC for prime brokerage clearing could be leveraged to develop a give up model, stating that any such model will need to provide for standardized documentation that facilitates additions and deletions of approved brokers, agreed-upon terms for rejection of trades by a sponsoring member, and centralized storage of delegation.¹²⁴

¹²² ICI Letter, *supra* note 85, at 12-28; Federated Letter, *supra* note 85, at 2-6.

¹²³ ICI Letter, *supra* note 85, at 12.

¹²⁴ ICI Letter, *supra* note 85, at 13-14.

The commenter requested that the SEC encourage FICC to establish a feature allowing (but not requiring) registered fund sponsored members to support their obligations by having margin posted with FICC (“FICC registered fund margin arrangement”) rather than by paying fees to the sponsoring member.¹²⁵ FICC’s rules currently provide that each sponsoring member must make a deposit to FICC’s Clearing Fund based on the activity of its sponsored members.¹²⁶ The contributions of all Netting Members, including those that are sponsoring members, are commingled in the Clearing Fund and are available to FICC for, among other things, securing members’ obligations and providing liquidity to meet its settlement obligations.¹²⁷ While the commenter stated that the Sponsored Service under current FICC rules does not raise custody issues for registered funds under the 1940 Act because registered funds are not required to post margin to FICC, if a fund’s margin were permitted to be posted with FICC, that could raise custody issues for funds unless such funds receive relief from certain provisions of the 1940 Act.¹²⁸ The commenter stated that permitting registered funds’ margin to be posted with FICC

¹²⁵ ICI Letter, *supra* note 85, at 14; Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association (Dec. 4, 2023), at 4 (“MFA Letter II”). *See also* MFA Letter, *supra* note 81, at 7 (noting that “an indirect participant should have the ability (although not the obligation) to fund the margin obligations of the direct participant clearing on its behalf which are attributable to the indirect participant. In such case, the margin posted by the indirect participant should be segregated from the direct participant’s house margin, and it should not be subject to loss mutualization vis-à-vis other direct participants. Given that many indirect participants have fiduciary obligations to their own clients, it is crucial that indirect participants are able to post margin on a segregated basis such that their clients are not subject to the credit risk of others (and, likewise, that their funds are not subject to loss mutualization).”); SIFMA/IIB Letter, *supra* note 37, at 12-13 (noting that “it will be difficult to support expanding cleared trading in U.S. Treasury securities until we have a framework which ensures customers can access clearing solutions where their margin and collateral will be adequately protected, including from loss mutualization by the clearing agency”).

¹²⁶ FICC Rule 3A, section 10, *supra* note 19.

¹²⁷ FICC Rule 4, *supra* note 19.

¹²⁸ Section 17(f) of the 1940 Act (providing that “[e]very registered management company shall place and maintain its securities and similar investments in the custody of (A) a bank or banks having the qualifications prescribed in paragraph (1) of section 26(a) of this title for the trustees of unit investment trusts; or (B) a company which is a member of a national securities exchange as defined in the Securities Exchange Act of

could reduce costs for registered funds and facilitate their use of cleared reverse repos and term repos.¹²⁹ The commenter also stated that the final rule should require FICC to establish margin rules that ensure that margin is held in a segregated manner, not commingled with any direct participant's house margin, and not be subject to loss mutualization associated with other direct participants.¹³⁰ Finally, the commenter stated that in order to address concerns regarding the security of registered fund assets under a Treasury repo clearing mandate, FICC rules addressing margin posting would need to be amended to provide for enhanced recordkeeping, internal controls, and transparency around the positions and related margin.¹³¹

In order to support a clearing requirement for eligible secondary market transactions, the Commission is taking the position that, for a period of five years, registered funds utilizing such an arrangement in a manner consistent with the circumstances described below would not provide a basis for enforcement action under Section 17(f) of the 1940 Act. The Commission takes this position to recognize the unique circumstances facing registered funds in the context of entering into eligible secondary market transactions using FICC's Sponsored Program.

1934, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (C) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors.”). *See also* rule 17f-1 under the 1940 Act (permitting registered funds to custody assets with a member of a national securities exchange as defined in the 1934 Act pursuant to certain conditions).

¹²⁹ ICI Letter, *supra* note 85, at 14.

¹³⁰ *Id.*

¹³¹ *See id.* (“Enhanced recordkeeping and related controls are critical to appropriately identifying ownership of assets during a Treasury repo or reverse repo transaction particularly since, unlike a typical derivatives or cash transaction, ownership of the Treasury securities underlying a repo or reverse repo change owners during the transaction.”).

Our staff has previously stated that it would not recommend enforcement action under the custody provisions of the 1940 Act in the context of certain registered fund trading activities.¹³² For example, the staff issued the Delta Letter in connection with Delta’s options clearing service, which provided assurances that the staff would not recommend enforcement action under Section 17(f) of the 1940 Act if registered investment companies deposited margin with Delta.¹³³ One representation in the Delta Letter was that Delta was permitted to withdraw the margin provided “only upon the investment company’s default on the option contract.”¹³⁴ Other previous staff no-action positions have been provided in different contexts. In one such no-action position, FICC represented that a registered fund’s margin would not be used to cover another client’s default and segregating fund assets from the custodian’s proprietary assets and other customers’ assets.¹³⁵ These types of features would help protect fund client assets consistent with the 1940 Act under the FICC registered fund margin arrangement, and we have included similar types of features for purposes of our position that follows below.

While the final rules do not require registered funds’ margin to be posted with FICC, and no current U.S. Treasury securities CCA has rules imposing such a requirement, as discussed above, a commenter requested that the Commission encourage FICC to establish a FICC registered

¹³² See e.g., Delta Government Options Corp. No-Action Letter (pub. avail. Sept. 27, 1990) (“Delta Letter”); cf. CME Group, Inc. No-Action Letter (pub. avail. Dec. 19, 2017); FICC No-Action Letter (pub. avail. Mar. 13, 2003) (“FICC 2003 Letter”). In the FICC Letter, the staff observed certain operational features of FICC’s Mortgage-Backed Securities Division (“MBSD”), which differ from the current circumstances of FICC’s Government Securities Division, such as registered funds being direct participants in MBSD’s clearing scheme and participant trades not being novated to MBSD. Any staff statements cited represent the views of the staff. They are not a rule, regulation, or statement of the Commission. Furthermore, the Commission has neither approved nor disapproved their content. These staff statements, like all staff statements, have no legal force or effect: they do not alter or amend applicable law; and they create no new or additional obligations for any person.

¹³³ Delta Letter.

¹³⁴ *Id.*

¹³⁵ See FICC 2003 Letter.

fund margin arrangement.¹³⁶ The Commission agrees that facilitating the ability for a registered fund's margin to be posted at FICC as an alternative to the sponsoring member posting the margin and passing the cost of doing so through to the registered fund may lower the cost of trading for the fund, and the Commission position below will help facilitate the posting of registered fund margin¹³⁷ to satisfy a U.S. Treasury securities CCA's margin deposit requirements.

Specifically, the Commission takes the position that, for a period of five years beginning on the effective date of this adopting release, if a registered investment fund's cash and/or securities are placed and maintained in the custody of FICC for purposes of meeting FICC's margin deposit requirements that may be imposed for eligible secondary market transactions in connection with the fund's participation in the Sponsored Program, it would not provide a basis for enforcement action under Section 17(f) of the 1940 Act *so long as*:¹³⁸

- FICC withdraws the margin provided by a sponsored member registered fund only upon that registered fund's default;¹³⁹
- The margin provided by a registered fund is not commingled with, and is kept separate from, FICC's assets;¹⁴⁰

¹³⁶ See ICI Letter, *supra* note 85, at 14.

¹³⁷ The Commission position is intended to address certain considerations under the 1940 Act specific to registered funds. Other types of buy-side participants may have different considerations to address in connection with their participation in the Sponsored Program beyond the scope of the 1940 Act.

¹³⁸ To the extent a registered fund becomes aware that its custodial arrangement is no longer consistent with the FICC registered fund margin framework, the registered fund may not utilize the FICC registered fund margin framework to enter into eligible secondary market transactions.

¹³⁹ For the avoidance of doubt, FICC may only withdraw margin provided by a registered fund in the event that the registered fund defaults on a transaction that has been novated to FICC.

¹⁴⁰ See FICC Letter; *see also* Institutional Equity Fund No-Action Letter (pub. avail. Feb. 27, 1984) (stating that the staff would not recommend enforcement action under Section 17(f) of the 1940 Act if, among other things, the assets of a registered fund participating in the Options Clearing Corporation's program were held in a "non-proprietary account at OCC which does not include any assets held by the Clearing Member agent other than as a fiduciary, custodian or otherwise for customers").

- FICC segregates on its books and records the margin provided by a registered fund (or series thereof, as applicable), and identifies a value of margin in its books and records as being attributable to the registered fund;
- The entity that FICC uses to custody such margin is an eligible fund custodian under the 1940 Act and the applicable rules thereunder;¹⁴¹
- The margin provided by a registered fund is not subject to loss mutualization¹⁴² or allocation;¹⁴³
- The margin provided by a registered fund is not used by FICC for any purpose other than in connection with that registered fund's default as a sponsored member;¹⁴⁴
- Registered funds receive quarterly statements of accounts concerning the margin provided in connection with eligible secondary market transactions showing, at a minimum, the name of the account, asset movements during the quarter, and quarter-end positions; and
- The account into which a registered fund's margin is deposited is governed by a contract by and among the registered fund, its sponsoring member, and FICC providing for an arrangement consistent with this Commission position, (together, the "FICC registered fund margin framework").¹⁴⁵

¹⁴¹ See Section 17(f) of the 1940 Act and the rules thereunder.

¹⁴² See FICC 2003 Letter at n. 18.

¹⁴³ See *e.g.*, FICC Rule 4, *supra* note 19.

¹⁴⁴ For purposes of this Commission position, FICC is not permitted to use registered fund margin for default liquidity purposes.

¹⁴⁵ The Commission notes that this position only applies with respect to the custody of registered fund margin, and does not apply to cash or collateral received under a sponsored repo or reverse repo trade. Further, this position does not impact any other obligation that a registered fund has in connection with its participation in the Sponsored Program or under the 1940 Act and rules thereunder.

In general, Section 17(f) of the 1940 Act and the rules thereunder govern the safekeeping of investment company assets.¹⁴⁶ The FICC registered fund margin framework is designed to protect fund investor assets, consistent with the principles of the 1940 Act.¹⁴⁷ The framework would seek to adequately protect registered fund assets by isolating them from FICC's proprietary assets and segregating them on FICC's books and records from the sponsoring member's other customers, preventing registered fund assets from being used to cover any obligation other than an obligation of that registered fund, limiting FICC's ability to use registered fund margin for any purpose other than an obligation of the registered fund as a sponsored member, and prohibiting registered fund assets from being subject to loss mutualization or allocation.¹⁴⁸ Five years is intended to provide sufficient time for FICC to develop and file any proposed rule changes under Section 19(b) of the Exchange Act that may be relevant to facilitate a registered fund's ability to have its margin posted at FICC consistent with the FICC registered fund margin framework. The Commission will consider any proposed rule changes consistent with its obligations under Section 19(b) of the Exchange Act in the event that FICC submits any proposal to facilitate a registered fund's ability to have its margin posted at FICC consistent with the FICC registered fund margin framework in the future, and providing this position for five years will also provide sufficient time for the Commission to determine if extending or revising this position is appropriate. Five years is intended to provide sufficient time for market participants to consider other potential frameworks

¹⁴⁶ The legislative history of section 17(f) indicates that Congress intended the assets of investment companies to be kept by a financially secure entity that has sufficient safeguards against misappropriation. *See* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 264 (1940).

¹⁴⁷ *See e.g.*, ICI Letter, *supra* note 85, at 14.

¹⁴⁸ *Cf. infra* part II.C.2.

for the posting of registered fund margin to satisfy FICC’s margin deposit requirements and to gain insight into the merits of such frameworks.¹⁴⁹

A registered fund may wish to use a member of a national securities exchange as a sponsoring member. Such a sponsoring member that receives and posts margin to a U.S. Treasury securities CCA on behalf of registered funds may be deemed to have custody of fund assets and implicate Rule 17f-1 under the 1940 Act. Therefore, the Commission takes the position, for a period of five years from the effective date of this adopting release, that if a registered fund’s cash and/or securities are placed and maintained with a sponsoring member that is a member of a national securities exchange, solely in connection with facilitating the posting of margin to FICC on behalf of a registered fund in connection with the registered fund’s participation in the Sponsored Program, it would not provide the basis for an enforcement action against a registered fund under Section 17(f) of the 1940 Act *so long as*: (i) the fund complies with Rule 17f-1(a), (b)(5), and (d), and (ii) the contract between the registered fund and the member of the national securities exchange provides for the following:

- The margin provided by a registered fund is not commingled with, and is kept separate from, the sponsoring member’s assets;¹⁵⁰

¹⁴⁹ We note that a U.S. Treasury securities CCA could develop a different mechanism for a registered fund to post margin. For example, the Options Clearing Corporation has a “deposits in lieu of margin” framework whereby a customer of a clearing member makes a deposit in lieu of margin through OCC’s escrow deposit program, and the relevant positions are excluded from the clearing member’s margin requirement to OCC. *See* OCC Rules 610, 610A, 610B, and 610C; *see also* Self-Regulatory Organization: The Options Clearing Corporation: Notice of Filing of Advance Notice Concerning the Options Clearing Corporation’s Escrow Deposit Program, Securities Exchange Act Rel. No. 34-78334 (Sept. 14, 2016), 81 FR 64537-38 (Sept. 20, 2016). Although there are fundamental differences in the purpose and use of margin in the OCC’s deposit in lieu of margin framework, a U.S. Treasury securities CCA could use the principles underlying the OCC’s program by analogy in developing its own margin posting framework.

¹⁵⁰ *See* note 140 *supra*.

- The sponsoring member segregates on its books and records the margin provided by a registered fund (or series thereof, as applicable), and identifies a value of margin in its books and records as being attributable to the registered fund;
- The registered fund's provision of margin is consistent with the FICC registered fund margin framework; and
- The sponsoring member does not hold registered fund assets that exceed the amount that is required to be deposited as margin to FICC with respect to the registered fund's outstanding eligible secondary market transactions.¹⁵¹

As above, such an approach is intended to accomplish a similar purpose as the FICC registered fund margin framework and additionally limit the amount of assets held in custody at a sponsoring member that is a member of a national securities exchange to an amount of margin that is required by FICC.

More generally, the Commission understands that the commenter which raised issues regarding the ability of registered funds to post margin to the CCA is referring to clearing models whereby an indirect participant in a U.S. Treasury securities CCA executes a transaction with a counterparty and then “gives up” the transaction to another party to submit for clearance and settlement. The Commission agrees with the commenter that the use of a “give up” model could be helpful in further facilitating the increased demand for central clearing under a potential clearing requirement. The Commission understands that FICC currently has certain models that facilitate “give up” style clearing, and, consistent with the requirement discussed in part II.B.2

¹⁵¹ This Commission position would not apply to the extent that the sponsoring member holds an amount of registered fund assets that exceeds the registered fund's margin obligations. If a sponsoring member were to hold registered fund assets in an amount that exceeds the registered fund's margin obligations, then the sponsoring member would need to return such excess to the registered fund as promptly as possible or promptly comply with all requirements of Rule 17f-1 under the 1940 Act.

infra, encourages U.S. Treasury securities CCAs to consider how best to facilitate “give up” clearing.

The Commission’s ability to “encourage” FICC, a covered clearing agency, must be considered in context of the relevant regulatory framework. Covered clearing agencies are SROs for purposes of the Exchange Act,¹⁵² meaning that, as an SRO, a covered clearing agency is required to file with the Commission any proposed rule or proposed change in its rules, including additions or deletions from its rules.¹⁵³ The Commission publishes all proposed rule changes for comment.¹⁵⁴ When considering whether to approve or disapprove a proposed rule change, the Commission shall approve the proposed rule change if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the particular type of SRO.¹⁵⁵

In addition, clearing agencies registered with the Commission are financial market utilities, as defined in section 803(6) of the Dodd-Frank Act.¹⁵⁶ A clearing agency that has been designated by the Financial Stability Oversight Council as systemically important or likely to become systemically important, and for which the Commission is the Supervisory Authority (“designated

¹⁵² 17 CFR 240.17ad-22(a)(5) (defining a covered clearing agency); 15 U.S.C. 78c(a)(26) (defining an SRO to include a registered clearing agency).

¹⁵³ An SRO must submit proposed rule changes to the Commission for review and approval pursuant to Rule 19b-4 under the Exchange Act. A stated policy, practice, or interpretation of an SRO, such as its written policies and procedures, would generally be deemed to be a proposed rule change. *See* 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. *See* 15 U.S.C. 78s(b)(3)(A) (setting forth the types of proposed rule changes that take effect upon filing with the Commission). The Commission may temporarily suspend those rule changes within 60 days of filing and institute proceedings to determine whether to approve or disapprove the rule changes. 15 U.S.C. 78s(b)(3)(C).

¹⁵⁴ *See* 15 U.S.C. 78s(b)(1). Proposed rule changes are generally required to be approved by the Commission prior to going into effect; however, certain types of proposed rule changes take effect upon filing with the Commission.

¹⁵⁵ 15 U.S.C. 78s(b)(1)(C)(i). On the other hand, the Commission shall disapprove a proposed rule change if it cannot make such a finding. 15 U.S.C. 78s(b)(1)(C)(ii).

¹⁵⁶ *See* 12 U.S.C. 5462(6).

clearing agency”), is required to file 60-days advance notice with the Commission of changes to rules, procedures, and operations that could materially affect the nature or level of risk presented by the designated clearing agency (“advance notice”).¹⁵⁷ Such an advance notice also requires consultation with the Board of Governors.¹⁵⁸ The Clearing Supervision Act authorizes the Commission to object to changes proposed in such an advance notice, which would prevent the clearing agency from implementing its proposed change(s).¹⁵⁹

These statutory requirements applicable to covered clearing agencies mean that the Commission must consider proposed rule changes as they are filed. The Commission does not dictate particular proposed rule changes that a CCA should adopt, although a CCA may determine that it should propose certain rule changes in response to a new or amended Commission rule. In response to this commenter, and as discussed in part II.B.2 *infra*, the Commission will consider any proposed rule changes filed by FICC, or any other U.S. Treasury securities CCA, in due course, consistent with its obligations under Section 19(b) of the Exchange Act. The Commission does not have the ability to revise particular aspects of the rules of an SRO that is a registered clearing agency, like a CCA.¹⁶⁰

¹⁵⁷ The Dodd-Frank Act defines a “designated clearing entity” as a designated financial market utility that is either a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1) or a clearing agency registered with the Securities and Exchange Commission under section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1). *See* 12 U.S.C. 5462(3). The Commission is the Supervisory Agency, as defined in 12 U.S.C. 5462(8), for four designated clearing agencies (the Depository Trust Company, the National Securities Clearing Corporation, the Fixed Income Clearing Corporation, and the Options Clearing Corporation). *See* 12 U.S.C. 5465(e)(1)(A). The Commission published a final rule concerning the filing of advance notices for designated clearing agencies in 2012. *See* 17 CFR 240.19b-4(n); Exchange Act Release No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012).

¹⁵⁸ *See* 12 U.S.C. 5465(e)(1)(B).

¹⁵⁹ *See* 12 U.S.C. 5465(e)(1)(E) and (F).

¹⁶⁰ 15 U.S.C. 78s(c) (establishing the Commission’s authority to, by rule, abrogate, add to, and delete from the rules of an SRO other than a registered clearing agency).

Second, the commenter discussed potential custody issues for registered funds under Section 17(f) of the 1940 Act and Rule 17f-4 thereunder. Section 17(f) requires that a registered fund maintain its securities and similar investments in a bank, a company which is a member of a national securities exchange, or its own custody.¹⁶¹ The commenter stated that substantially all funds use a bank custodian, and that a bank custodian is particularly beneficial to funds in the context of repo and reverse repo transactions with respect to custodizing both securities and cash.¹⁶²

The Commission has adopted rules that specify required qualifications for entities other than those named in Section 17(f) to act as custodians of fund assets, including Rule 17f-4 which permits a registered fund to deposit the securities it owns in a securities depository, under certain conditions.¹⁶³ A “securities depository” is defined to include a clearing corporation that is registered with the Commission under Section 17A of the Exchange Act.¹⁶⁴ The commenter observed that FICC is registered as a clearing agency, but that FICC has stated that it is not a securities depository and does not provide securities depository services.¹⁶⁵ The commenter asserted that, because FICC is not deemed to be a securities depository eligible to custody fund assets, expanding the Sponsored Service for funds would require addressing Section 17(f) “if the offering would require margin posting by funds,” and stated that one way to do this would be for FICC to obtain Commission relief to hold fund margin as an eligible securities depository within the meaning of Rule 17f-4.¹⁶⁶

¹⁶¹ 15 U.S.C. 80a-17(f)(1).

¹⁶² ICI Letter, *supra* note 85, at 15.

¹⁶³ 17 CFR 270.17f-4.

¹⁶⁴ 17 CFR 270.17f-4.

¹⁶⁵ ICI Letter, *supra* note 85, at 15.

¹⁶⁶ ICI Letter, *supra* note 85, at 15-16.

The Commission is not opining on whether FICC’s Government Securities Division could currently be considered a “securities depository” for purposes of Rule 17f-4.¹⁶⁷ However, the amendments to Rule 17ad-22(e) do not require that registered funds post margin directly to a U.S. Treasury securities CCA, meaning that this issue is not implicated at this time. Therefore, the Commission does not believe that such concerns are ripe for consideration, as no U.S. Treasury securities CCA has proposed particular rules that would require the posting of registered funds’ securities at the CCA and such an arrangement is not specifically required by the requirement to clear eligible secondary market transactions. Moreover, as discussed in this part above, the Commission has taken the position regarding the FICC registered fund margin framework in light of the commenter’s concern.

The Commission’s definition of an eligible secondary market transaction and the requirement to clear such transactions does not, on its own, mandate particular changes to FICC’s membership models, including the Sponsored Service. FICC has not proposed any rule changes with respect to the Sponsored Service in this regard at this time. The Commission will consider any proposed rule changes consistent with its obligations under Section 19(b) of the Exchange Act in the event that FICC submits any such proposal in the future.

¹⁶⁷ The commenter’s assertion that FICC has stated that it is not a securities depository and does not provide securities depository services comes from a statement in FICC’s Disclosure Framework concerning a different regulatory regime. Specifically, the statement concerns whether FICC is a “central securities depository” or provides “central securities depository” services, for purposes of discussing FICC’s obligation to comply with Rule 17ad-22(e)(10), which applies to CCAs that provide central securities depository services. “Central securities depository” is a defined term in the Covered Clearing Agency Standards, meaning a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Act (15 U.S.C. 78c(a)(23)(A)). Section 3(a)(23)(A) defines a securities depository, in turn, as who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.

Third, the commenter stated that FICC’s rules addressing margin posting will need to be amended to provide for enhanced recordkeeping, internal controls, and transparency around the positions and related margin, to address fund concerns regarding the security of fund assets under a requirement to clear certain transactions. The commenter stated that enhanced recordkeeping and related controls are critical to appropriately identifying ownership of assets during a repo transaction particularly since, unlike a typical derivatives or cash transaction, ownership of the U.S. Treasury securities underlying a repo transaction changes during the transaction. The commenter asserted that FICC currently relies on its broker-dealer members and, in certain cases, designated agency banks to maintain records regarding margin positions, and that FICC has indicated that it is not able to identify positions or possess the assets of its members’ customers. The commenter states that notwithstanding FICC’s current lack of infrastructure, “the Proposal relies heavily on FICC to intermediate transactions under a clearing mandate and contemplates that this approach will provide a higher level of safety to the market than the current bilateral market, which relies on a well-diversified group of credit-worthy banks to hold collateral, including through robust tri-party arrangements, and utilizes an industry standard agreement that is well understood by market participants.”¹⁶⁸

However, no U.S. Treasury securities CCA has proposed particular rules that would require the posting of registered funds’ securities at the CCA. The Commission’s definition of an eligible secondary market transaction and the requirement to clear such transactions does not, on its own, mandate particular changes to FICC’s membership models, including the Sponsored Service. The Commission will consider any proposed rule changes consistent with its obligations under Section 19(b) of the Exchange Act in the event that FICC submits any such proposal in the future.

¹⁶⁸ ICI Letter, *supra* note 85, at 16-17.

The Commission disagrees with the commenter's assertion that FICC has indicated that it is not able to identify positions or possess the assets of its members' customers. FICC currently is able to maintain position data for customer positions in all its indirect access models.¹⁶⁹ In addition, under the amendments being adopted in this release, FICC will, as discussed in section II.B.1 *infra*, be required to separately calculate and hold customer margin (which it currently does for the Sponsored Service), which addresses the commenter's concern that FICC calculate and hold customer margin separately.

Fourth, the commenter highlighted its support for strong protections for fund assets, including "legally segregated, operationally commingled" ("LSOC") protections. In addition, another commenter asserted that, without an exclusion from the definition of an eligible secondary market transaction for repos with registered funds, such funds could be subject to greater counterparty credit risk because the existing Sponsored Member clearing model at FICC has no requirement to segregate customer assets, while at present most registered funds use third-party custodians to hold securities and cash.¹⁷⁰ The Commission addresses these comments in more detail in part II.B.1 below.

Fifth, the commenter stated that the Commission and FICC must address the bankruptcy treatment of certain fund assets. Specifically, the commenter stated that FICC's rules should confirm that agreements entered into by repo counterparties will be enforceable against both parties, notwithstanding that the transactions are cleared, and provide a clear process for closeout of transactions by FICC, including both the start and end legs of the transaction. The commenter

¹⁶⁹ FICC Buyside FAQ at 4, *available at* <https://www.dtcc.com/ustclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-GSD-FAQ.pdf> ("FICC records positions of Sponsored Members and positions of Executing Firms of a Prime Broker as long as the Prime Broker submits the trades to FICC using a unique client identifier called the "Executing Firm symbol.") ("FICC Buyside FAQ").

¹⁷⁰ SIFMA AMG Letter, *supra* note 35, at 5.

also stated that FICC’s rules need to address what happens upon the insolvency of a sponsoring member in a variety of factual circumstances, including providing for prompt replacement of the sponsoring member by its sponsored members and handling of other functions typically performed by the sponsoring member to ensure that transactions by the sponsored member are maintained and allowing the sponsored member the authority to receive certain reports directly and to post to the clearing fund to preserve pending trades. The commenter also stated that FICC’s rules should provide clarity regarding how non-defaulting parties, such as funds, can exercise closeout rights, including those available under Sections 555, 559, 561, and similar sections of the U.S. Bankruptcy Code. The commenter stated that if, in the future, FICC decides to expand the Sponsored Service to permit (but not require) sponsored members to post margin, then the Commission and FICC should clarify that the margin posted by a sponsored member with its sponsoring member for on-posting with FICC would be eligible for customer treatment under the Securities Investor Protection Act (“SIPA”). The commenter also argues that clarification of FICC’s rules regarding closeout rights – particularly in respect to “done away” trades – is important to clarify a repo counterparty’s rights under different insolvency regimes applicable to cleared transactions.¹⁷¹

Regarding these bankruptcy-related comments, FICC’s rules already address the issues raised by the commenter. For example, with respect to the enforceability of the agreements entered into by repo counterparties, FICC requires applicants for membership to execute a Membership Agreement, in which the applicant agrees to be bound by FICC’s Rules, and FICC further requires applicants for membership to provide a legal opinion regarding the membership

¹⁷¹ ICI Letter, *supra* note 85, at 20-21.

agreement, which incorporates FICC's Rules.¹⁷² Novation consists of the termination of the deliver, receive, and related payment obligations between the parties to a trade, and their replacement with identical obligations to and from FICC in accordance with the Rules. Once it novates a transaction, FICC contractually replaces the original counterparties' obligations to each other with two sets of obligations, both of which include FICC and one of the original counterparties.¹⁷³ FICC is not a party to the pre-novation bilateral agreements between a Sponsoring Member and its Sponsored Members, and therefore, it cannot guarantee performance of those contracts.

In addition, with respect to FICC's need to establish a process for closeout, FICC's Rules contain these processes. Upon ceasing to act for an insolvent member, FICC may promptly close out and manage the member's positions, including with respect to the member's pending transactions with non-defaulting members.¹⁷⁴ Specifically, FICC would terminate and net all of the insolvent member's positions, after which FICC would liquidate the net positions through market action and determine a single net amount owed to or from the insolvent member from or to FICC.¹⁷⁵ After closing out the insolvent member's final net positions, FICC's Rules provide for the timely settlement of all deliver, receive, and related payment obligations that would have arisen had FICC not ceased to act for the insolvent member (*i.e.*, FICC would seek to fulfill its settlement obligations with respect to the insolvent member's pending transactions with non-defaulting

¹⁷² FICC Rule 2A, Section 7, *supra* note 19; FICC Disclosure Framework, Principle 1, *available at* https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf.

¹⁷³ FICC Rule 5, section 8 (regarding novation generally) and Rule 3A, section 7(a) (regarding novation in the Sponsored Service), *supra* note 19.

¹⁷⁴ FICC Rule 22A, Section 2, *supra* note 19.

¹⁷⁵ *See id.*

members.)¹⁷⁶ Similarly, in the event that FICC determines to treat a Sponsoring Member as insolvent, FICC would cease to act for the Sponsoring Member.¹⁷⁷ FICC would determine whether to close-out the affected Sponsored Member Trades and/or permit the Sponsored Members to complete their settlement.¹⁷⁸ In the event that it closes out the Sponsored Member's transactions, it would follow the same closeout process.¹⁷⁹

Moreover, these comments generally relate to particular features of FICC's Sponsored Service, including how the sponsored member is able to interact with FICC, FICC's ability to settle the transactions in the event of a Sponsoring Member default, and the operation of certain bankruptcy provisions. For the reasons discussed in more detail in part II.B.2 *infra*, the Commission cannot change the rules governing the Sponsored Service.

Sixth, the commenter identified issues for registered funds that would arise if additional clearing were to require funds to contribute to FICC's CCLF. The commenter explained that contribution by a registered fund to the CCLF could result in a prohibited joint transaction in violation of: Section 17(d) of the 1940 Act if affiliates of the fund (*e.g.*, other funds managed by the same investment adviser) also contribute to the fund; Section 18 of the 1940 Act, which prohibits a registered fund from issuing "senior securities;" Section 17(f) of the 1940 Act; the fund's investment purpose, policies, and organization documents; or the fiduciary duties of the fund's board and its investment adviser. The commenter asserts that the Commission would need to carefully evaluate the ability of a registered fund to become a FICC netting member and contribute to the CCLF, as well as amending its rules to confirm that view, or that, in the

¹⁷⁶ See *id.*

¹⁷⁷ FICC Rule 3A, Section 16(b), *supra* note 19.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

alternative, FICC could create a special category of netting member that would not require a fund to contribute to the CCLF.¹⁸⁰

In response to this commenter, any requirement for a U.S. Treasury securities CCA to have policies and procedures requiring its direct participants to clear eligible secondary market transactions does not, on its own, require any particular market participant to become a direct participant of a U.S. Treasury securities CCA, thereby taking on the membership obligations of such participation, including contribution to the CCLF. The Commission acknowledges the commenter's view that certain regulatory provisions applicable to registered funds could effect a registered fund's ability to join a U.S. Treasury securities CCA directly, but the Commission does not believe that these concerns should impact its consideration of the proposal as the proposal would not impose such requirements. Consistent with its obligations under Section 19 of the Exchange Act, in its review of any rule filings, the Commission would consider issues related to the ability of market participants, including registered funds, to participate in FICC.

Seventh, the commenter stated that bilateral tri-party repo should be exempted from the definition of an eligible secondary market transaction. The Commission has considered this comment in part II.A.2.a.i *supra*.

In addition, certain commenters also provided specific arguments regarding money market funds subject to Rule 2a-7 under the 1940 Act.¹⁸¹ One commenter stated that the Commission should not include repos with money market funds subject to Rule 2a-7 within the definition of an eligible secondary market transaction, noting that the current ability to transact in Treasury repurchase agreements across a variety of clearance and settlement platforms allows these funds to

¹⁸⁰ ICI Letter, *supra* note 85, at 22.

¹⁸¹ Federated Letter, *supra* note 85, at 3; ICI Letter, *supra* note 85, at 5-8.

be invested in a manner that is in the best interest of their shareholders. The commenter also referred to the planning and tools that have been developed that seek to avoid a disorderly default in repurchase agreement markets. The commenter also stated that the likely insolvency regimes for the major repurchase agreement participants that would be facilitated by a receiver (either the Federal Deposit Insurance Corporation or the Securities Investor Protection Corporation) allow the receiver to transfer or wind down repurchase agreements in an orderly manner.¹⁸²

Two commenters raised questions with respect to regulatory diversification requirements, that is, whether registered funds, including money market funds, will continue to meet the definition of a “collateralized fully” repurchase agreement under Rule 5b-3 under the Investment Company Act of 1940 if Treasury repo investments through the Sponsored Service grow significantly.¹⁸³ Commenters explained that meeting the definition of a “collateralized fully” repurchase agreement under Rule 5b-3 is necessary for Treasury repurchase agreements to remain permissible investments for a government money market fund and for achieving “look through” treatment for certain diversification requirements imposed under the 1940 Act and Internal Revenue Code.¹⁸⁴ One commenter asked that the Commission confirm through rulemaking or guidance that repo clearing offerings made available by FICC to registered funds “would continue to satisfy” the “collateralized fully” standard set forth in Rules 5b-3 and 2a-7 under the 1940 Act and would allow funds to achieve “look through treatment” for diversification purposes.¹⁸⁵

¹⁸² Federated Letter, *supra* note 85, at 3 (citing SEC. & EXCH. COMM’N, DIV. OF INV. MGMT GUIDANCE UPDATE: COUNTERPARTY RISK MANAGEMENT PRACTICES WITH RESPECT TO TRI-PARTY REPURCHASE AGREEMENTS (July 2013), available at <https://www.sec.gov/divisions/investment/guidance/im-guidance-2013-03.pdf>).

¹⁸³ 17 CFR 270.5b-3(c)(1). Federated Letter, *supra* note 85, at 6; ICI Letter, *supra* note 85, at 23-24.

¹⁸⁴ Federated Letter, *supra* note 85, at 6; ICI Letter, *supra* note 85, at 23-24.

¹⁸⁵ ICI Letter, *supra* note 85, at 23-24.

One commenter also referenced the need for relief for reverse repo transactions. The commenter stated that, unlike Treasury repo agreements that are “collateralized fully,” Treasury reverse repo transactions entered into by funds (*i.e.*, where a fund is the seller) currently are not eligible for look-through treatment. The commenter concludes that this means that, under the proposal, absent additional rulemaking or relief, most money market funds would be limited to investing no more than 5% of their total assets in reverse repo agreements because funds would face FICC as the counterparty, and that diversified non-money market funds would be limited to investing either no more than 25% of their total assets in reverse repo agreements or no more than 5%, with respect to 75% of their total assets, in reverse repo agreements. The commenter stated that registered funds may use Treasury reverse repo agreements as a form of short-term financing to facilitate shareholder redemption requests.¹⁸⁶

The Commission acknowledges that the final rule could limit the extent to which some registered funds enter into Treasury reverse repo agreements. However, the Commission believes that this effect will be limited because a relatively small number of funds report Treasury reverse repo agreements on Form N-PORT, and funds generally have other available means to generate cash to meet shareholder redemption requests, such as lines of credit, securities lending, interfund lending, or selling portfolio investments, as applicable. The combined effect of the final rule and the diversification requirements in section 5(b) of the 1940 Act could practically limit the amount some funds may invest in Treasury reverse repo.¹⁸⁷

¹⁸⁶ ICI Letter, *supra* note 85, at 25.

¹⁸⁷ Section 5(b) divides management investment companies into “diversified companies” and “non-diversified companies.” Under this section, (i) a “diversified company” means a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in

The commenter separately suggested that the final rule would affect money market funds' use of Treasury reverse repo agreements, in light of additional diversification requirements for those funds. However, money market funds are not permitted to rely on rule 18f-4 under the 1940 Act to enter into reverse repo transactions.¹⁸⁸ Moreover, money market funds historically have not reported holdings of reverse repo agreements in their portfolio reports filed with the Commission.

The Commission's definition of an eligible secondary market transaction and the requirement to clear such transactions does not mandate particular changes to FICC's membership models, including the Sponsored Service. FICC has not proposed any rule changes with respect to the Sponsored Service in this regard at this time. The Commission will consider any proposed rule changes consistent with its obligations under Section 19(b) of the Exchange Act in the event that FICC submits any such proposal in the future. In the event that any U.S. Treasury securities CCA proposes a clearing model in which registered funds would be required to place and maintain assets to effect eligible secondary market transactions at the CCA, the Commission would consider the applicability of Section 17(f) of the 1940 Act.

One commenter explained that registered funds' access to the Treasury repo market could be restricted by the number or willingness of the FICC netting members to provide sponsoring services with attending negative effect on the market liquidity.¹⁸⁹ Although increases in demand for the Sponsored Service may put pressure on existing sponsoring members and reduce their

value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer and (ii) a "non-diversified company" means any management company other than a diversified company. See section 5 of the 1940 Act.

¹⁸⁸ See Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 34084 (Nov. 2, 2020), 85 FR 83162 (Dec. 21, 2020); 17 CFR 270.18f-4. Rule 18f-4 establishes a framework for funds' use of derivatives and certain other transactions, including reverse repurchase agreements. Money market funds are not permitted to rely on rule 18f-4 for these transactions.

¹⁸⁹ ICI Letter, *supra* note 85, at 30-31.

ability or willingness to onboard additional clients, this could also present an opportunity for dealers that currently do not offer the Sponsored Service to enter the market, resulting in more competition and a wider range of counterparties. This is supported by an observation of a growing number of dealers offering the Sponsored Service and the growing volume of sponsored repo indicating increased adoption of this service by a wider range of market participants.¹⁹⁰

Several commenters raised concerns about the potential effect of the proposal and a potential resultant high level of exposure to the U.S. Treasury securities CCA on ratings assigned to certain money market funds by Nationally Recognized Statistical Rating Organizations (NRSROs).¹⁹¹ The commentators explained that NRSROs typically establish exposure limits that a rated money market fund may have to any particular CCA and, if these limits are breached, a fund may not be able to maintain the currently assigned rating.¹⁹² The Commission does not have the authority to adjust the NRSROs' rating criteria and methodologies, and it cannot anticipate how NRSROs may adjust their rating criteria and methodologies in response to the U.S. Treasury market infrastructure changes resulting from the adoption of the Membership Definition.

iii. Repos by Other Clearing Organizations

Several commenters supported a limited exclusion from the definition of an eligible secondary market transaction for U.S. securities transactions entered into by a derivatives clearing organization ("DCO"). A DCO is an entity that is regulated by the CFTC and is defined as a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction (i) enables each party to

¹⁹⁰ See Sponsored DVP and GC Repo Activity, *available at* <https://www.dtcc.com/charts/membership>.

¹⁹¹ Federated Letter, *supra* note 85, at 6-7; ICI Letter, *supra* note 85, at 25-26; SIFMA AMG Letter, *supra* note 35, at 14.

¹⁹² *Id.*

the agreement, contract, or transaction to substitute, through novation or otherwise, the DCO's credit for the credit of the parties; (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by the DCO's participants; or (iii) otherwise provides clearing services or arrangements that mutualize or transfer among the DCO's participants the credit risk arising from such agreements, contracts, or transactions executed by the participants.¹⁹³ Generally, DCOs perform similar functions as CCAs, but for commodities as opposed to securities.

One commenter recognized that DCOs are not specifically enumerated as an entity type subject to the expanded clearing requirement, but stated that, in practice, it would be impractical for DCOs to avoid entering into repos with direct participants of U.S. Treasury CCAs, which would therefore be included in the definition of an eligible secondary market transaction.¹⁹⁴ First, the commenter stated that an exclusion for DCOs was necessary to allow DCOs to retain the flexibility necessary to effectively manage risk when managing the default of a participant of the DCO, with respect both to access to the appropriate counterparties and to pressing time considerations. The commenter stated that requiring the central clearing of repos entered into for default management by a DCO could undermine the effectiveness of the DCO's default management practices. Second, the commenter asserted that including transactions with a DCO within the definition of an eligible secondary market transaction would threaten DCOs' effective cash management. The commenter stated that DCOs regularly receive U.S. dollar cash as margin from their clearing members and then enter into reverse repos, as permitted under the applicable CFTC regulations. However, the commenter expressed concern that the permissible counterparties

¹⁹³ 7 U.S.C. 1a(15) (defining DCO) and 7a-1(a) (establishing DCO registration requirement).

¹⁹⁴ CME Letter, *supra* note 81, at 6.

and counterparty concentration limits included in CFTC Rule 1.25 would appear to be in tension with the requirement to clear eligible secondary market transactions because a clearing agency, which would become the counterparty to any transaction that is centrally cleared, is not a permissible counterparty. Finally, the commenter stated that allowing transactions with DCOs to be scoped into the definition of an eligible secondary market transaction would be inconsistent with the spirit, and the letter, of Section 5b(f)(1) of the Commodity Exchange Act, which states that “under no circumstances shall a [DCO] be compelled to accept the counterparty credit risk of another clearing organization.”¹⁹⁵

An additional commenter made similar arguments. This commenter stated that the rule as proposed could create contagion risk by increasing linkages between CCPs, stating that this risk would crystallize if a CCP clearing its investment trades contributed to the mutualized financial resources of another CCP via its default fund or was otherwise exposed to loss in the event of a member default of the other CCP. The commenter further stated that existing regulations under both U.S. and European regulatory frameworks recognize the potential financial stability risks of inter-CCP linkages and prohibit them from accepting the counterparty credit risk of another CCP. According to the commenter, one such conflict arises under the Commodity Exchange Act where, to minimize systemic risk, there is a requirement that “[. . .] under no circumstances shall a derivatives clearing organization be compelled to accept the counterparty credit risk of another clearing organization.” Finally, the commenter states that a clearing model tailored to meet CCPs’ bespoke collateral management requirements would need to be developed before they could operationally clear investment trades.¹⁹⁶

¹⁹⁵ CME Letter, *supra* note 81, at 6-7.

¹⁹⁶ Letter from Rachel Goldberg, Head of Government Relations and Regulatory Strategy, Americas, London Stock Exchange Group, at 2-3 (June 15, 2023).

The Commission understands that reverse repos are used heavily by central counterparties as a means of investing their cash.¹⁹⁷ The Commission also agrees that entities that provide central counterparty services, like DCOs and clearing agencies, must be able to effectively manage the default of a participant.¹⁹⁸ In the event of a participant default, the need for such entities to be able to react within potentially compressed timeframes, including by engaging in repos of U.S. Treasury securities held as margin to create liquidity, may be essential to their default management processes. The Commission agrees that including such transactions within the scope of an eligible secondary market transaction might have systemic risk implications and counteract the goals of effective and efficient default management by CCPs in such scenarios. Accordingly, it is appropriate to exclude repos entered into by an entity acting as a central counterparty from the definition of an eligible secondary market transaction.¹⁹⁹

To do so, the Commission is modifying the definition of an eligible secondary market transaction in Rule 17ad-22(a) to exclude any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a covered clearing agency providing central counterparty services, a derivatives clearing organization (*see* 7 U.S.C. 7a-1 and 17 CFR 39.3), or is regulated as a central counterparty in its home jurisdiction. With respect to a counterparty that is regulated as a central counterparty in its home jurisdiction, this portion of the exclusion encompasses entities that may serve as central counterparties in their home jurisdiction and may transact in repos with direct participants of a U.S. Treasury securities CCA. Although commenters did not specifically suggest this exclusion for a counterparty that is regulated as a

¹⁹⁷ See BIS, Committee on the Global Financial System, Repo Market Functioning, Apr. 2017.

¹⁹⁸ Proposing Release, *supra* note 14, 87 FR at 64627.

¹⁹⁹ The Commission is not opining on the proposal's consistency with the Commodity Exchange Act or other regulatory regimes, but the commenter's concern is moot in light of the modification to the definition of an eligible secondary market transaction that the Commission is adopting.

CCP in its home jurisdiction, this aspect of the exclusion is appropriate to ensure that entities serving as central counterparties in other jurisdictions are similarly excepted from the definition of an eligible secondary market transaction as repo counterparties.

iv. Repos by FCMs

Two commenters asked the Commission to adopt an exemption that would allow Futures Commission Merchants (“FCMs”) to continue to engage in eligible secondary market transactions in U.S. Treasury securities outside of central clearing, and another commenter acknowledged the potential interaction between the proposal and the regulatory framework governing FCMs.²⁰⁰ An FCM is an entity engaged in soliciting or accepting orders for the purchase or sale of commodities, futures, swaps, or other instruments regulated by the CFTC.²⁰¹ FCMs can also be registered with the Commission as broker-dealers.²⁰² In their role as market intermediaries, FCMs hold customer funds and securities. The commenter explained that as of October 31, 2022, FCMs held an aggregate amount of more than \$500 billion in segregated customer accounts, a substantial percentage of which is held in the form of U.S. Treasury securities.²⁰³

As the commenter noted, FCMs are required under the Commodity Exchange Act²⁰⁴ and the regulations promulgated thereunder²⁰⁵ to assure the protection of customer funds. Specifically,

²⁰⁰ See comments from Walt L. Lukken, President and Chief Executive Officer, Futures Industry Association, at 2-7 (Dec. 23, 2022) (“FIA Letter”). See also SIFMA/IIB Letter, *supra* note 37, at 30-31 (recognizing that the absent an exemption for FCMs from the central clearing requirement, FCMs engaging in repo transactions would be placed in the untenable position of violating either the SEC’s proposal or existing CFTC regulations). See also DTCC/FICC Letter, *supra* note 33, at 25 (recognizing that CFTC regulations currently limit FCM access to central clearing by preventing FCMs from entering into FICC-cleared repo transactions using customer property).

²⁰¹ See 7 U.S.C. 1a(28)(A).

²⁰² One commenter states that the majority of FCMs are dually registered as FCMs and broker-dealers. See FIA Letter, *supra* note 200, at 2.

²⁰³ See FIA Letter, *supra* note 200, at 4.

²⁰⁴ 7 U.S.C. 1-26.

²⁰⁵ 17 CFR 1.1-190.19.

as the commenter explained, FCMs are required to hold customer funds and securities in segregated accounts with a bank or other permitted depository that acknowledges such customer assets “will be separately accounted for and segregated” from the FCM’s own funds and “must otherwise be treated in accordance with the provisions of the [CEA]” and CFTC rules.²⁰⁶ The commenter highlighted that neither the bank/depository nor the FCM may use the FCM’s customer funds to “secure or guarantee any obligations” that the FCM might owe to the bank/depository or make the funds “subject to any right of offset or lien for or on account of any indebtedness, obligations, or liabilities” the FCM may owe the bank/depository.²⁰⁷ The commenter expressed concern as to whether the account structure provided by FICC would be consistent with these rules.

As an initial matter, the requirement for direct participants of a U.S. Treasury securities CCA to clear eligible secondary market transactions does not require that an FCM post customer assets directly to the U.S. Treasury securities CCA. An FCM could access central clearing through a customer model, such as the Sponsored Service or the Prime Broker/Correspondent clearing models, that allows the customer/FCM to hold customer assets elsewhere (such as at the Sponsoring Member) and does not require that the FCM post customer assets to the U.S. Treasury securities CCA. Therefore, the ability of the CCA to provide an account structure consistent with the CFTC Rules should not prevent an FCM’s transactions from being submitted to central clearing.

Moreover, in light of the requirements regarding the segregation of house and customer margin, as discussed in part II.B.1 *infra*, and the amendments to Rule 15c3-3, as discussed in part

²⁰⁶ See FIA Letter, *supra* note 200, at 3 (discussing 17 CFR 1.20 (regarding futures traded on U.S. futures exchanges) and 17 CFR 22.4 (regarding cleared swaps)).

²⁰⁷ FIA Letter, *supra* note 200, at 3-4 (discussing 17 CFR 1.20, 22.2, and 30.7).

II.C *infra*, U.S. Treasury securities CCAs will have to ensure that they have adopted policies and procedures to separate house and customer margin and to establish certain types of segregated accounts. The Commission encourages FCMs seeking the ability to post customer funds directly to the CCP to engage with the CCAs to consider whether such new account structures may be sufficient to comply with the provisions of the CFTC regulations that the commenter has identified or whether such structures could be leveraged to meet the commenter's needs. For example, the Commission understands that the existing U.S. Treasury securities CCA recently has indicated that it would develop customer clearing account structures in which each customer's margin would be calculated on a gross basis and held physically segregated from all other FICC margin and would also be legally segregated from FICC member as well as fellow customer exposures.²⁰⁸

One of the commenters also explained that FCMs are permitted to invest customer funds in certain securities determined by the CFTC to be "consistent with the objectives of preserving capital and maintaining liquidity."²⁰⁹ The commenter stated that permitted investments include, among other things, U.S. Treasury securities, and investments with U.S. Treasury securities may be made by either direct purchase or sale or by entering into repo transactions.²¹⁰ The commenter further explained that, for repo transactions, an FCM's "permitted counterparties are limited to a bank..., securities broker-dealer, or government securities dealer registered with the [Commission]," and a clearing agency is not a permitted counterparty.²¹¹

The commenter stated that, absent relief, conflict between the CFTC rules and the proposal would effectively prohibit FCMs from entering into U.S. Treasury security transactions pursuant to

²⁰⁸ DTCC 2023 White Paper, *supra* note 107, at 22-23.

²⁰⁹ FIA Letter, *supra* note 200, at 4-5 (discussing 17 CFR 1.25(b)).

²¹⁰ FIA Letter, *supra* note 200, at 4-5 (discussing 17 CFR 1.25(a)).

²¹¹ FIA Letter, *supra* note 200, at 5 (discussing 17 CFR 1.25(d)(2)).

CFTC Rule 1.25.²¹² The commenter explained that a U.S. Treasury securities CCA interposes itself between the counterparties to a securities transaction through novation, acting functionally as the buyer to every seller and seller to every buyer.²¹³ Therefore, according to the commenter, if an FCM were to conduct a cleared transaction, the CCA would become the FCM's counterparty. Since a CCA is not a permitted FCM counterparty under the CFTC rules, the commenter states that FCMs are prohibited from conducting such cleared transactions.²¹⁴ The commenter contended that if the Commission adopts the requirement to clear eligible secondary transactions as proposed, an FCM would lose its current ability to conduct transactions in U.S. Treasury securities with a direct participant of a U.S. Treasury securities CCA in compliance with CFTC rules.²¹⁵

The Commission recognizes that if the FCM were to access a U.S. Treasury securities CCA through a model like FICC's Sponsored Service, the CCA would novate the transaction and become the counterparty to the FCM, which, as the commenter has described it, would not be consistent with Rule 1.25(d)(2) with respect to permitted counterparties. However, the requirement to clear eligible secondary market transactions does not require that the FCM use a particular type of model that would make the FCM a counterparty to a CCA. The FCM could access central clearing through an agent clearing model like FICC's Prime Broker or Correspondent Clearing models, in which it would essentially "give up" its transaction to a direct participant for submission without becoming a counterparty to the CCA, which should be consistent with the FCM's obligations under Rule 1.25(d)(2). Therefore, this requirement to clear

²¹² FIA Letter, *supra* note 200, at 6.

²¹³ FIA Letter, *supra* note 200, at 6; *see also* Proposing Release, *supra* note 14, 87 FR at 64612.

²¹⁴ FIA Letter, *supra* note 200, at 6 (citing 17 CFR 1.25(d)(2)).

²¹⁵ *See* FIA Letter, *supra* note 200, at 6.

eligible secondary market transactions does not obligate the FCM to use a model that would necessarily result in a transaction with a clearing agency as the counterparty to the FCM.

The Commission recognizes this apparent tension between the application of Rule 1.25(d)(2), as described by the commenter, and the requirement to clear repos as part of the definition of eligible secondary market transactions.²¹⁶ However, as discussed in the Proposing Release, when Congress added section 17A to the Exchange Act as part of the Securities Acts Amendments of 1975, it directed the Commission to facilitate the establishment of (i) a national system for the prompt and accurate clearance and settlement of securities transactions (other than exempt securities) and (ii) linked or coordinated facilities for clearance and settlement of securities transactions, and the Government Securities Act of 1986 specifically included government securities within the scope of section 17A.²¹⁷ The Commission therefore has the ability to make rules governing central clearing in the U.S. Treasury market, which may affect a diverse group of market participants, including FCMs. The Commission encourages interested parties to work with the CCA to identify any modifications to its client clearing models to better allow FCMs to access central clearing in the U.S. Treasury market. In addition, FCMs could enter into repos with market participants that are not direct participants of a U.S. Treasury securities CCA.²¹⁸

The commenter also notes that CFTC rules require that securities transferred to an FCM's customer segregated custodial account must be "made on a delivery versus payment [(DVP)] basis

²¹⁶ See CFTC Global Market Advisory Committee ("GMAC"), Global Market Structure Subcommittee, CFTC Rule 1.25(d)(2) Recommendation (discussing the impact of Rule 1.25(d)(2) on FCMs' ability to participate in cleared repo), available at <https://www.cftc.gov/PressRoom/Events/opaeventgmac110623>. The CFTC's GMAC voted in favor of this recommendation to amend Rule 1.25(d)(2) to include CCAs as permitted counterparties.

²¹⁷ Proposing Release, *supra* note 14, 88 FR at 64617.

²¹⁸ CFTC Rule 1.25(a)(1) also identifies additional types of permitted investments available to an FCM for its customer funds, including municipal bonds, corporate bonds, and interests in money market mutual funds.

in immediately available funds.”²¹⁹ Even if a U.S. Treasury securities CCA would be a permitted FCM counterparty under the CFTC rules, the commenter expressed concern that upon the sale or resale of securities in a repo transaction, the FCM’s customer segregated cash account may not receive same-day funds credited simultaneously with the delivery or transfer of securities.²²⁰ The Commission does not believe that such concerns are warranted. FICC clears all transactions DVP meaning that payment of cash is made at the same time as delivery of securities.

Finally, the commenter also explained that CFTC rules require that the agreement between an FCM and a repo counterparty must “make[] clear that, in the event of the [FCM’s]...bankruptcy, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement [must] also make[] clear that, in the event of an [FCM’s]...bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.”²²¹ The commenter also expressed concern that there is no assurance that a U.S. Treasury securities CCA would agree to the bankruptcy provisions in the CFTC rules applicable to FCMs described above.²²² However, as stated in the discussion above, the

²¹⁹ FIA Letter, *supra* note 200, at 5 (discussing 17 CFR 1.25(d)(9)).

²²⁰ *See id.*

²²¹ FIA Letter, *supra* note 200, at 5 (discussing 17 CFR 1.25(d)(13)).

²²² *See id.* The commenter also noted that the CFTC has advised that “in-house transactions” in which an FCM receiving customer collateral that is not acceptable at a Derivatives Clearing Organization (“DCO”) or foreign board of trade may, independent of CFTC Rule 1.25 requirements, exchange that collateral for acceptable collateral to the extent necessary to meet margin requirements. The commenter requested confirmation from the Commission that such “in-house transactions” would similarly not be subject to the proposed clearing requirement were an FCM to conduct transactions with a participant of a U.S. Treasury securities CCA. If such transactions are with a participant of a U.S. Treasury securities CCA and otherwise meet the definition of an eligible secondary market transaction, then they would be subject to the requirement.

requirement to clear eligible secondary market transactions does not require that the FCM enter into a repo agreement with the CCA.

For the reasons discussed above, the Commission does not believe that an exclusion for FCMs is necessary to accommodate the relevant provisions of the CFTC Rules. Moreover, an exclusion for FCMs would be inconsistent with the purpose of the rule which is to help reduce contagion risk to the CCA and bring the benefits of central clearing to more transactions involving U.S. Treasury securities, particularly in light of their significance to the Treasury market.

v. Repos involving “End Users”

One commenter argued that transactions by commercial entities participating in the Treasury repo market solely for investing their extra cash balances should be excluded from the definition of an eligible secondary market transaction. The commenter stated that corporations are often required under their credit agreements to invest cash in specified cash equivalents, which typically include Treasury repos, and that these transactions are likely to be quite limited in size.²²³ The commenter suggested that the Commission could leverage the definition of commercial end user in the uncleared security-based swap margin rules or non-financial end user in the uncleared swap margin rules (which both similarly contain exemptions for such entities).²²⁴

Another commenter requested a similar exclusion, stating that commercial entities that enter into cash or repo transactions do so for various, legitimate purposes, but that these entities’ trading is rarely large in size and the costs of these transactions being cleared would ultimately outweigh the benefits. The commenter also stated that such an exclusion would be consistent with the exemption in the Commission’s uncleared swap margin rules.²²⁵ An additional commenter

²²³ SIFMA/IIB Letter, *supra* note 37, at 22.

²²⁴ *Id.* (citing 17 CFR 240.18a-3(b)(2), and 23.151; 12 CFR 45.2).

²²⁵ AIMA Letter II, *supra* note 115, at 3.

requested the same exclusion for non-financial commercial end users, such as corporations and municipalities. The commenter stated that these types of entities typically transact in U.S. Treasury repos for funding and liquidity management purposes, and that the increased costs of centrally clearing such transactions may outweigh the willingness of these types of entities to continue to use U.S. Treasury securities for funding and liquidity management purposes, thus eliminating an effective corporate management tool without advancing the Commission's stated policy objectives.²²⁶

The Commission understands that in addition to cash assets obtained through credit agreements, other sources of corporate cash exist that do not typically have accompanying investment limitations, such as equity capital, retained earnings, sales of assets, and legal settlements, among others. Investments of the combined surplus cash by corporate treasurers are typically aligned with the firm's projected cash needs and may include a range of investment options in addition to Treasury repos.²²⁷ As of June 30, 2023, balances of liquid assets held by nonfinancial corporations are estimated at approximately \$6.9 trillion.²²⁸ While the commenter stated that such an exclusion may be warranted because the Treasury repo investments are likely to be limited in size, commercial end-users could change the size of their Treasury repo investments, including by entering into large Treasury repo investments, or by using alternative options for the short-term investment of cash that share a similar risk profile, such as a money market fund, depending on many firm-specific and market factors. For example, commercial end-users may

²²⁶ See Morgan Stanley Letter, *supra* note 85, at 2.

²²⁷ Association of Finance Professionals, 2023 AFP Liquidity Survey, *available at* <https://www.afponline.org/publications-data-tools/reports/survey-research-economic-data/Details/liquidity-survey>.

²²⁸ Federal Reserve, Financial Accounts of the United States, L.103 Nonfinancial Corporate Business (the broad measure of liquid assets includes cash held in banks' accounts and deposits, and cash invested in various liquid financial assets), *available at* <https://www.federalreserve.gov/releases/z1/20230908/html/1103.htm>.

increase allocations to U.S. Treasury repos for credit diversification, particularly at times of market stress. U.S. Treasury repos may offer higher yields, particularly at times when issuance of Treasury securities increases and dealers seek financing to complete settlement by borrowing more cash in the repo market. The high liquidity of Treasury repos could also be attractive to commercial end-users, especially if a significant amount of liquidity needs to be accumulated to complete a corporate transaction such as a merger or an acquisition.

An exemption for end users could permit commercial entities to enter into Treasury repo investments without the risk-reducing benefits of central clearing. In addition, due to the variety of sources of cash available to commercial entities besides those obtained through credit agreements and the size of corporate liquid assets held by commercial entities, excluding commercial entities from the scope of the definition of an eligible secondary market transaction would not be consistent with the intent to reduce risk and enhance efficiency of the U.S. Treasury market.²²⁹ The Commission also disagrees with the contention that the increased costs arising from the clearing mandate would impede the willingness of commercial entities to continue to use the Treasury repo market for funding and liquidity management purposes. As discussed in part I *supra*, central clearing allows market participants to reduce costs and increase operational efficiency, among other benefits, which would, in turn, lead to lower funding costs in the repo market and greater availability of liquidity for all market participants, including commercial end-users.

Moreover, the Commission disagrees with the commenter's suggestion that it could leverage the definitions used in exempting certain end users from swap clearing requirements. The

²²⁹ Association of Finance Professionals, 2023 AFP Liquidity Survey, *available at* <https://www.afponline.org/publications-data-tools/reports/survey-research-economic-data/Details/liquidity-survey>.

commercial end user in the uncleared security-based swap margin rules is defined as a counterparty to the swap that is (i) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) meets certain reporting obligations associated with entering into non-cleared swaps.²³⁰ The exemption is intended to ensure that certain types of commercial entities are able to continue to use swaps to manage their specific commercial risks and are not unduly burdened by the need to post margin. The end-user exemption from clearing for swaps may not be available to all commercial entities entering swaps. When implementing the exemption, the CFTC specifically required, among other things, that the end user must be using the swap to hedge or mitigate commercial risk, and that the swap that is hedging or mitigating commercial risk cannot be used for a purpose that is in the nature of speculation, investing, or trading.²³¹ In addition, the counterparty that elected the end-user exception must provide reports relating to its ability to meet financial obligations associated with entering into non-cleared swaps.²³²

In contrast, the commercial end user activity in the U.S. Treasury repo market is unrelated to the commercial activity of these users. Investment of surplus cash is an activity similar to that of institutional asset managers such as registered funds or other managed investments. As discussed above, investing is a type of activity that would not qualify the end-user exemption in the swap market. For the reasons here and above, the Commission does not believe that an exception for commercial end users is appropriate in the Treasury repo market.

vi. Interaffiliate Repos

One commenter recommended that the Commission exempt transactions in U.S. Treasury securities between affiliates from any central clearing requirement. The commenter stated that

²³⁰ Commodity Exchange Act section 2(h)(7); Exchange Act section 3C(g).

²³¹ 17 CFR 50.50(a)(1)(ii) and (c)(2)(i).

²³² 17 CFR 50.50(b).

inter-affiliate transactions are important to corporate groups, which may use them to achieve efficient risk and capital allocation and obtain flexibility for addressing customer demands.²³³

The commenter further stated that requiring inter-affiliate transactions to be centrally cleared would impose additional costs with limited benefits, for two reasons. First, if an inter-affiliate transaction is part of a “back-to-back arrangement,” meaning that the related external transaction between the affiliated counterparty and a non-affiliated counterparty is not centrally cleared, then subjecting the inter-affiliate transaction to a central clearing requirement does nothing to reduce the contagion risk presented by the non-affiliated counterparty. The commenter further asserted that if that external transaction is already centrally cleared, the contagion risk would already be addressed and requiring the inter-affiliate transaction to be cleared would not create additional benefits. Second, a direct participant’s affiliate’s credit risk is already part of the group-wide financial risks to which the Treasury CCP is exposed, and central clearing of inter-affiliate transactions is unlikely to meaningfully impact the risk profile.²³⁴ The commenter stated that, for similar reasons, the CFTC has exempted inter-affiliate swaps from the swap mandatory clearing rules.²³⁵

Additional commenters made similar arguments. For example, one commenter stated that the definition of an eligible secondary market transaction should not apply to transactions between a direct participant of a U.S. Treasury securities CCA and its affiliates. The commenter explained that a CCA’s direct participants provide a range of risk management, collateral management, asset-liability management, and funding and liquidity services to their affiliates, including affiliated U.S. broker-dealers, and that imposing the definition of those direct participants’ transactions with

²³³ SIFMA/IIB Letter, *supra* note 37, at 21-22.

²³⁴ SIFMA/IIB Letter, *supra* note 37, at 21-22.

²³⁵ *See id.* at 22 n. 66 (citing generally 17 CFR 50.52).

affiliates would be potentially disruptive and unnecessary to advance the Commission's stated policy objectives.²³⁶ Another commenter stated that a requirement to clear transactions between affiliates would create new, unnecessary costs without any benefits.²³⁷

As discussed in more detail in part IV.B, the Commission understands that inter-affiliate transactions represent an important tool to transfer liquidity and risk within an affiliated group. These transactions may serve different purposes, including, but not limited to, providing U.S. Treasury securities for delivery when an affiliate has taken a long or short position in U.S. Treasury securities as a hedge against other exposures, allowing the movement of U.S. Treasury securities to allow them to be posted as margin on an affiliate's transaction, ensuring that U.S. Treasury securities can serve as a liquidity buffer for an affiliated bank,²³⁸ or to meet liquidity composition targets. To get the U.S. Treasury securities to the appropriate entity within an affiliated group, the affiliate often enters into repos or reverse repos with a direct participant of a U.S. Treasury securities CCA.

In certain circumstances, the counterparty credit risk posed by inter-affiliate transactions may be less than other transactions.²³⁹ However, affiliated entities are separate legal entities and, generally, are not legally responsible for each other's contractual obligations. In the event that one or more affiliated entities becomes insolvent, the affiliates, as separate legal entities, would be

²³⁶ See Morgan Stanley Letter, *supra* note 85, at 1-2.

²³⁷ AIMA Letter II, *supra* note 115, at 3.

²³⁸ A liquidity buffer generally refers to liquid assets that a banking organization manages to enable it to meet expected and unexpected cash flows and collateral needs without adversely affecting the banking organization's daily operations. See generally FRB, FDIC, & OCC, Q&As on Statement Regarding the Use of Capital and Liquidity Buffers (Mar. 17, 2020), available at <https://www.fdic.gov/news/financial-institution-letters/2020/fil20020a.pdf>.

²³⁹ See, e.g., Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 FR 50425, 50427 (Mar. 2012) (discussing the internalization of counterparty risk on inter-affiliate swap transactions as wholly owned members of the same corporate group, but also discussing that similar benefits may not accrue for other inter-affiliate swaps when the counterparties are not members of the same group).

managed as separate estates in a bankruptcy, with the trustee having a duty to the creditors of the affiliate, not the affiliated family. Thus, the Commission does not agree that a U.S. Treasury securities CCA is exposed to the group-wide financial risks of a direct participant's affiliated group.

In response to the comments received, the Commission is modifying the definition of an eligible secondary market transaction in Rule 17ad-22(a) to conditionally exclude inter-affiliate repurchase and reverse repurchase transactions. Specifically, the Commission is excluding from that definition any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities entered into between a direct participant and an affiliated counterparty, provided that the affiliated counterparty submits for clearance and settlement all other repurchase or reverse repurchase agreements collateralized by U.S. Treasury securities to which the affiliated counterparty is a party. By referring to all *other* repos or reverse repos, the exemption clarifies that the requirement does not encompass transactions between the direct participant and the affiliate, *i.e.*, the transactions that are excluded, and also does not encompass the affiliate's transactions that would otherwise be excluded under sections (iii), (iv), or (v) of the definition of an eligible secondary market transaction. This exclusion is appropriate to ensure that affiliated groups can continue to use inter-affiliate repo transactions to transfer liquidity or risk, while also conditioning that ability on the affiliated counterparty's submission of its eligible secondary market repo transactions for clearance and settlement.²⁴⁰

²⁴⁰ Although the commenter referred generally to inter-affiliate transactions, without specifying cash versus repo, the Commission is limiting the exclusion to repo transactions only for two reasons. First, inter-affiliate cash transactions would only be included in the definition of an eligible secondary market transaction if they met the definition of such transaction, as discussed further in part II.A.2.b. Second, as discussed in this section and in part IV.B.3.b.v, the Commission understands that the inter-affiliate transactions referenced by the commenter typically take the form of repo or reverse repo transactions.

Regarding the conditional nature of the exclusion, the Commission agreed with the commenter that if the external transaction of a “back-to-back” arrangement in which the related external transaction between the affiliated counterparty and a non-affiliated counterparty is centrally cleared, the contagion risk would already be addressed and requiring the inter-affiliate transaction to be cleared would not create additional benefits. To ensure that this is the case, the Commission is conditioning the availability of the exclusion for inter-affiliate transactions on an obligation for the affiliated counterparty to submit its repo transactions, other than those with its direct participant counterparty, for clearance and settlement. This condition should also help ensure that a direct participant cannot rely upon an inter-affiliate transaction to avoid the requirement to clear eligible secondary market transactions. If there were no such condition, a direct participant could simply use inter-affiliate transactions to move securities and funds to affiliates, and the affiliated counterparty could then enter into external transactions with counterparties which, if entered into as a direct participant of a U.S. Treasury securities CCA, would be eligible secondary market transactions.²⁴¹ The Commission did not limit this condition to only the “back-to-back” transactions because such transactions may not serve as the only potential means by which inter-affiliate transactions can be used to evade the requirement to clear eligible secondary market transactions, and for that matter, may not serve as the only potential means by which such transactions can transfer risk.²⁴² This condition should lessen the potential for any impacts arising from the default of an inter-affiliate transaction to spread throughout an

²⁴¹ The Commission acknowledges that the affiliated counterparty’s transactions may encompass transactions to which the requirement to clear eligible secondary market transactions already applies, either because the affiliated counterparty is transacting with another direct participant of a U.S. Treasury securities CCA or because the affiliated counterparty is itself a direct participant of a U.S. Treasury securities CCA. The condition for the affiliate to clear its repo or reverse repo transactions would also apply, however, even if the affiliate is not a direct participant of a U.S. Treasury securities CCA.

²⁴² *See, e.g.*, Final Rule, Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21761-62 (Apr. 11, 2013).

affiliated group because it would ensure that the external facing transactions of an affiliated counterparty would be centrally cleared, if the direct participant wanted to exclude its inter-affiliate transactions.²⁴³

This approach to an inter-affiliate exclusion for repos is consistent with the CFTC's treatment of this issue in the swaps market, as the commenter suggested. As part of its inter-affiliate swap exemption, the CFTC also included a requirement that the swaps entered into by the affiliated counterparties with unaffiliated counterparties must be cleared.²⁴⁴ This approach to an inter-affiliate exclusion for repos is also similar to the existing rules with respect to inter-affiliate transactions in place at FICC, as the only U.S. Treasury securities CCA. FICC's rules require that its direct participants submit the transactions of particular affiliated counterparties (referred to as a Covered Affiliate), *i.e.*, those that are not also direct participants, that are not foreign entities, and that are either broker-dealers, banks, trust companies, and/or FCMs, if that transaction is with another direct participant or another direct participant's Covered Affiliate.

To accommodate this exclusion, the Commission is also adopting in Rule 17ad-22(a) a definition of an affiliated counterparty for purposes of the definition of an eligible secondary market transaction. Specifically, an affiliated counterparty would be defined as any counterparty which meets the following criteria: (i) the counterparty is either a bank (as defined in 15 U.S.C. 78c(6)), broker (as defined in 15 U.S.C. 78c(4)), dealer (as defined in 15 U.S.C. 78c(5)), or futures commission merchant (as defined in 7 U.S.C. 1a(28)), or any entity regulated as a bank, broker, dealer, or futures commission merchant in its home jurisdiction; (ii) the counterparty holds,

²⁴³ Moreover, the condition is consistent with the commenters' views noting that in the event that the external transaction is centrally cleared, the benefits of central clearing would be realized. *See* AIMA Letter II, *supra* note 115, at 3.

²⁴⁴ *See* 17 CFR 50.52(a)(4)(i)(E).

directly or indirectly, a majority ownership interest in the direct participant, or the direct participant, directly or indirectly, holds a majority ownership interest in the counterparty, or a third party, directly or indirectly, holds a majority ownership interest in both the direct participant and the counterparty; and (iii) the counterparty, direct participant, or third party referenced in (ii) as holding the majority ownership interest would be required to report its financial statements on a consolidated basis under U.S. Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of the majority-owned party or of both majority-owned parties. With respect to the types of entities that can be considered an affiliated counterparty, this definition is consistent with how the current U.S. Treasury securities CCA 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 exemption. The reference to entities that are regulated as banks, brokers, dealers, or futures commission merchants in their home jurisdictions encompasses foreign affiliates of direct participants of a U.S. Treasury securities CCA. This aspect of the definition of an affiliated counterparty is meant to ensure that, to take advantage of the conditional inter-affiliate exemption, a direct participant of a U.S. Treasury securities CCA would have to ensure that the transactions of both domestic and foreign affiliates are submitted for clearing. Similarly, with respect to what constitutes affiliated, that is, the specific identification of ownership interest to describe the requisite custody or control to be considered affiliated, this definition is consistent with the definition used by the CFTC for purposes of the inter-affiliate swap exemption. This consistency, and additional specificity about

the requisite custody or control, should be helpful to the direct participants of a U.S. Treasury securities CCA when determining compliance with this conditional exemption.²⁴⁵

This exemption is conditional, and a direct participant of a U.S. Treasury securities CCA may choose not to use the exemption, meaning that its affiliated counterparty would not be required to submit its repo transactions, other than those with its direct participant counterparty, for clearance and settlement. If a direct participant chooses to use the exemption, its affiliated counterparty could submit its transactions in several ways, including through an indirect clearing model (*e.g.*, at FICC, the affiliated counterparty could be a Sponsored Member or use the Prime Broker or Correspondent Clearing models to submit its transactions for clearance and settlement) or by becoming a direct participant of the CCA.²⁴⁶

vii. Repos by State and Local Governments

Several commenters argued that regulatory and practical constraints on the state and local government level could limit their ability to centrally clear their Treasury repo and reverse repo transactions.²⁴⁷ The commenters stated that authorizing statutes and local ordinances in several states only permit repo transactions with a bank or a government securities dealer counterparty.²⁴⁸ As such, a centrally cleared repo, which is novated to a CCA may not comply with these statutes or ordinances, because the CCA would be the counterparty. One commenter also highlighted

²⁴⁵ Rule 17ad-22(a) currently contains a definition of a “participant family” for purposes of Rule 17ad-22(b)(3), (d)(14), (e)(4), and (e)(7). 17 CFR 240.17ad-22(a)(12). This term is defined to mean that if a participant directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another participant then the affiliated participants shall be collectively deemed to be a single participant family for purposes of the specified portions of Rule 17ad-22. The Commission believes that a more specific and granular definition of an affiliated counterparty would be helpful for the purposes of the inter-affiliate exclusion because it would address any potential uncertainty about whether an entity controls, is controlled by, or is under common control with, another entity.

²⁴⁶ See notes 680 and 681 *infra* and accompanying text regarding these models.

²⁴⁷ SIFMA AMG Letter, *supra* note 35, at 14; Federated Letter, *supra* note 81, at 7; IDTA Letter, *supra* note 66, at 10.

²⁴⁸ *Id.*

specific collateralization requirements (*e.g.*, 102%) by several states to their repo counterparties and raised concerns that varying levels of margining in central clearing of such trades could create a conflict with state laws.²⁴⁹ The commenters argued that amending state and local governments' authorizing statutes through the legislative actions of an applicable body would take a substantial amount of time and would disrupt investments of public funds in the Treasury repo market with a negative effect on market liquidity.²⁵⁰ Considering these challenges, the commenters suggested exempting state and local governments from the scope of the definition of an eligible secondary market transaction.

The Commission agrees with the commenters that it would be appropriate to adopt an exclusion for any repurchase or reverse repurchase transaction collateralized by U.S. Treasury securities between a direct participant and a state or local government, in light of both the potential conflicts with state and local government authorities related to their investments and because of the nature and size of U.S. Treasury market activity by such entities.

According to the United States Census Bureau's 2017 Census of Governments data, there were over 90,000 local governments in the United States, including county, city, municipality, township, and special purpose governments as well as nearly 13,000 independent school district governments.²⁵¹ Many of these local governments operate only small budgets and access the Treasury repo market infrequently and on a small scale for secured investment of their surplus cash

²⁴⁹ IDTA Letter, *supra* note 66, at 10.

²⁵⁰ SIFMA AMG Letter, *supra* note 35, at 14; Federated Letter, *supra* note 81, at 7; IDTA Letter, *supra* note 66, at 10; *see also* Letter from James Tabacchi, Chairman, Independent Dealer and Trader Association and attached whitepaper at 5 (Sept. 1, 2023) (discussing the fact that most states and municipalities use Master Repo Agreements based on local law and would by statute be unable to sign a New York law-based agreement to clear through a U.S. Treasury securities CCA).

²⁵¹ United States Census Bureau, "2017 Census of Governments – Organization," Table 2: Local Governments by Type and States and Table 9: Public School System by Types of Organization and State, available at <https://www.census.gov/data/tables/2017/econ/gus/2017-governments.html>.

balances. While comprehensive data about investment activity of state and local governments are lacking, the costs of building legal and operational infrastructure to access central clearing by most of these governments may prevent them from accessing the Treasury repo market.

The Commission does not believe that such an exclusion should apply to any pension or retirement plan established or maintained by a state, any of its political subdivisions, or any agency or instrumentality of a state or any of its political subdivisions, for the benefit of its employees (or any beneficiaries of its employees). Such state pension and retirement plans generally do not face the same statutory restrictions as state and local governments regarding their investments,²⁵² and indeed, several such plans are currently Sponsored Members of FICC.²⁵³

Moreover, state pension and retirement plans manage a substantial amount of assets and are important participants in the Treasury repo market. In contrast to surplus cash balances of state and local governments that are expected to be managed with the principal preservation objective, public pension and retirement plans typically have more sizable assets under management and pursue a long-term return objective employing a variety of return-enhancing strategies, including the use of leverage.²⁵⁴ As of March 31, 2023, total funded assets under management of these plans

²⁵² See, e.g., California Government Code section 20190 (providing that Board of Advisors of Public Employee Retirement System may, in its discretion, invest the assets of the fund through the purchase, holding, or sale thereof of any investment, financial instrument, or financial transaction when the investment, financial instrument, or financial transaction is prudent in the Board's informed opinion); N.Y. Retire. & Soc. Sec. Law 177 (identifying eligible investments of NY state public pension funds, without limiting the counterparties to a repo); Wis. Stat. 325.17 (identifying eligible investments for Wisconsin state public pension funds to various instruments, without limiting the counterparties to a repo).

²⁵³ DTCC, FICC-GSD Member Directories, Sponsored Member Listings, *available at* <https://www.dtcc.com/client-center/ficc-gov-directories> (showing five state and local pension plans as Sponsored Members).

²⁵⁴ See, e.g., California Public Employees' Retirement System Total Fund Investment Policy, *available at* <https://www.calpers.ca.gov/docs/total-fund-investment-policy.pdf>; State of Wisconsin Investment Board, Investment Strategy, *available at* <https://www.swib.state.wi.us/investmentstrategy>; Teachers Retirement System of Texas, Investment Strategy, *available at* https://www.trs.texas.gov/Pages/investment_strategy.aspx.

were approximately \$5.3 trillion.²⁵⁵ A survey conducted by the National Association of State Retirement Administrators found that the average public pension fund allocates around 2.5% of its assets to cash investments, which would include investments in the Treasury repo market.²⁵⁶ Given the total asset size of the state pension and retirement plans and the variety of investment strategies that they can pursue as well as their ability to participate in central clearing under their governing statutes, excluding these plans from the scope of the definition of an eligible secondary market transaction would be inconsistent with the intent to reduce risk and enhance efficiency of the U.S. Treasury market.

The Commission is therefore excluding from the definition of an eligible secondary market transaction any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a state or local government. In addition, the Commission would add a definition of state and local government to Rule 17ad-22(a) to mean a state or any political subdivision thereof, or an agency or instrumentality of a State or any political subdivision thereof, but not to include any pension or retirement plan established or maintained by a state, any of its political subdivisions, or any agency or instrumentality of a state or any of its political subdivisions, for the benefit of its employees (or any beneficiaries of its employees).²⁵⁷

²⁵⁵ Federal Reserve, Financial Accounts of the United States, L.120 State and Local Government Employee Retirement Funds (total funded assets are considered), *available at* <https://www.federalreserve.gov/releases/z1/20230608/html/1120.htm>. This data set consists of retirement systems that are administered by a recognized unit of a state or local government as defined by the Bureau of the Census and whose members are public employees compensated with public funds. It includes the defined benefit (DB) and defined contribution (DC) retirement funds of both state governments and local government entities such as counties, municipalities, townships, school districts, and special districts.

²⁵⁶ National Association of State Retirement Administrators, Investments, *available at* <https://www.nasra.org/investment>.

²⁵⁷ “State” is defined in Exchange Act section 3(a)(16) as any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.

viii. Other Repo Comments

One commenter suggested that the Commission should provide further specificity around the definition of a repurchase or reverse repurchase agreement, suggesting that it may be advisable for the Commission to adopt the definition used by the current U.S. Treasury securities CCA.²⁵⁸ The commenter suggested that this definition is indifferent to the method of documentation, making it clear that inclusion in the definition does not depend on the particular documentation the parties elect to use, such as a Master Securities Lending Agreement or Master Securities Loan Agreement.²⁵⁹ The Commission does not believe that further revision of the definition is necessary.

The definition of an eligible secondary market transaction, both as proposed and as adopted, applies to all types of transactions that are of a type currently accepted for clearing at a U.S. Treasury securities CCA. It does not impose a requirement on a U.S. Treasury securities CCA to offer additional products for clearing. One commenter specifically agreed that the proposal should apply to the types of transactions that are eligible for clearing at a U.S. Treasury securities CCA, as those eligibility criteria evolve over time. The commenter stated that such an approach would ensure that the requirement would not inadvertently give rise to risk or undue costs by forcing into central clearing transaction types that have not gone through a methodical risk analysis or for which the costs may outweigh the benefits, while at the same time, it would allow the requirement to evolve as U.S. Treasury securities CCAs, their direct participants, and

²⁵⁸ DTCC/FICC Letter, *supra* note 33, at 11-12 (citing the FICC definition of a Repo Transaction, which covers “(1) an agreement of a party to transfer Eligible Securities to another party in exchange for the receipt of cash, and the simultaneous agreement of the former party to later take back the same Eligible Securities (or any subsequently substituted Eligible Securities) from the latter party in exchange for the payment of cash, or (2) an agreement of a party to take in Eligible Securities from another party in exchange for the payment of cash, and the simultaneous agreement of the former party to later transfer back the same Eligible Securities (or any subsequently substituted Eligible Securities) to the latter party in exchange for the receipt of cash”).

²⁵⁹ DTCC/FICC Letter, *supra* note 33, at 11-12.

regulators identify transaction types that would benefit from central clearing.²⁶⁰ The Commission agrees that the definition being adopted will allow for this type of approach to the clearing requirement.

Several commenters discussed whether securities lending should be included within the scope of this definition.²⁶¹ Securities lending transactions do not fall within the scope of the definition of an eligible secondary market transaction and are not currently available for central clearing.

One commenter requested clarification that the definition of an eligible secondary market transaction does not apply to final settlement under physical-delivery futures contracts on U.S. Treasury bonds or notes (“Treasury futures”). The commenter noted that such Treasury futures are already subject to a central clearing requirement and described how the physical delivery process works, that is, if a Treasury future goes to delivery, then the commenter, which centrally clears Treasury futures, would inform long clearing members of the U.S. Treasury securities 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.²⁶² The Commission agrees with the commenter that the physical settlement of Treasury futures does not fall within the definition of an eligible secondary market transaction because it does not fit within the specific categories set forth

²⁶⁰ DTCC/FICC Letter, *supra* note 33, at 12-13.

²⁶¹ See BNY Mellon Letter, *supra* note 33, at 2 (suggesting additional analysis before requiring the central clearing of securities lending transactions, as well as consideration of a non-cash model for central clearing such transactions); Federated Hermes Letter, *supra* note 85, at 7-8 (stating that securities lending transactions should not be included in a clearing mandate because they are subject to different market infrastructure than repurchase agreements, which has not been adapted to facilitate cleared securities lending transactions); Letter from Fran Garritt, Director, Securities Lending & Market Risk and Mark Whipple, Chairman, Committee on Securities Lending Risk Management Association (Dec. 23, 2022) (arguing generally that the scope of an eligible secondary market transaction not be expanded to include securities lending transactions because of the negative impact on beneficial owners, the increased costs, and lack of infrastructure); SIFMA/IIB Letter, *supra* note 37, at 22; ICI Letter, *supra* note 85, at 12 n.35.

²⁶² CME Letter, *supra* note 81, at 7-8.

in the rule. In addition, the Treasury futures are already subject to central clearing, thereby ensuring that the benefits of central clearing are already present in this aspect of the market.

Another commenter did not support a requirement to clear repos, but stated that if such a requirement were adopted, it should be limited to repos by interdealer brokers (“IDBs”) and broker-dealers because (1) the counterparties to such transactions are the most active participants in the Treasury repo markets, thereby allowing the Commission to meaningfully increase central clearing without applying a more categorical requirement, and (2) such transactions are more interconnected with the rest of the market and have a higher possibility to transfer risk to outside parties (including potentially a U.S. Treasury securities CCA).²⁶³ The Commission disagrees that the definition of an eligible secondary market transaction should be limited in this manner. As discussed in part II.A.2.a *supra*, there are substantive benefits that will arise from the broad scope of the repo market, including with respect to balance sheet netting and greater capacity of dealers to intermediate repos. Further, the Commission disagrees that these transactions are “more interconnected with the rest of the market,” because it generally is not possible to quantify interconnectedness in this manner. Even if a repo is between a dealer and its customer neither of which is an IDB or a broker-dealer, the failure of that transaction could have an impact on its counterparties and transmit that risk to the broader market.

In addition, several commenters requested exemptions for transactions entered into outside of the operating hours of a U.S. Treasury securities CCA that would settle on or before the next day on which the CCA is open for business. For example, one commenter stated that firms routinely enter into U.S. Treasury securities transactions after the close of business at FICC, for legitimate business or operational reasons, including for treasury management purposes, and that

²⁶³ SIFMA/IIB Letter, *supra* note 37, at 19-20.

firms will need the ability to enter into transactions at times that a CCA is not open to accept transactions for novation. The commenter compared the situation to the derivatives context in which a swap subject to mandatory clearing is executed after 4 p.m. or not on a business day, it must then be submitted by the next business day when a derivatives clearing organization is open.²⁶⁴ Another commenter stated that market participants may enter into a transaction after the close of a CCA's operating/business hours, making it unable to accept the transaction for clearing and novation. The commenter stated that the Commission should therefore exempt these transactions from a final rule, unless and until the existing U.S. Treasury securities CCA can change its operating hours to account for such transactions or another CCA becomes available with 24/7 clearing capabilities.²⁶⁵

Such an exemption is not necessary. The existing U.S. Treasury securities CCA accepts all bilateral DVP trades for novation from 7 a.m. until 8 p.m. eastern time.²⁶⁶ This window is available for submission and novation of bilateral repo transactions, which would be novated in real-time upon submission. The Commission understands that market participants may enter Treasury repo transactions outside the normal U.S. business hours when trades are accepted by U.S. Treasury CCA for novation. A review of repo trading data shows that the largest share of repo trading activity is conducted during the first 1.5 hours of a trading day from 7 a.m. to 8:30 a.m. eastern time.²⁶⁷ This early morning activity may include repo trades that were arranged prior to the U.S. Treasury market opening at 7:00 a.m. The Commission does not anticipate the final

²⁶⁴ SIFMA/IIB Letter, *supra* note 37, at 21 (citing CFTC Rules 50.1 and 50.2).

²⁶⁵ AIMA Letter II, *supra* note 115, at 2-3.

²⁶⁶ See FICC Rules, Schedule of Timeframes, *supra* note 19.

²⁶⁷ Clark *et al.*, Intraday Timing of General Collateral Repo Markets, Federal Reserve Bank of New York Liberty Street Economics (July 14, 2021), *available at* <https://libertystreeteconomics.newyorkfed.org/2021/07/intraday-timing-of-general-collateral-repo-markets>.

rule affecting this established market practice. With respect to triparty repo, any U.S. Treasury securities CCA must interact with the timelines for triparty repo more generally, which rely upon the Fedwire Funds Service to transfer funds, and Fedwire has a deadline for initiating transfers for the benefit of a third party is 6 p.m. eastern time.²⁶⁸ The existing U.S. Treasury securities CCA accepts triparty submissions from 7 a.m. until 5 p.m. and novates the activity upon settlement of the start leg of the triparty repos, provided that settlement occurs by 5:30 p.m.²⁶⁹ The existing timeline accommodates completion of the activity at the CCA before the Fedwire deadline.

Finally, one commenter requested clarification that the definition of an eligible secondary market transactions would not include instances in which market participants post U.S. Treasury securities as collateral to secure transactions in a wide range of asset classes, including cleared and uncleared swaps and listed futures.²⁷⁰ This type of transaction does not meet the definition of a repurchase or reverse repurchase agreement adopted in Rule 17ad-22(a); therefore, it would not be within the scope of an eligible secondary market transaction.

ix. Final Rule

For the reasons set forth in part II.A.2.a, the Commission is adopting the definition of an eligible secondary market transaction in Rule 17ad-22(a), specifically as it relates to repurchase and reverse repurchase agreements, as proposed, except that it is adopting exclusions from the scope of that definition for repos by other clearing organizations, repos by state and local governments, and inter-affiliate repos.

²⁶⁸ See Fedwire Funds Services, *available at* https://www.federalreserve.gov/paymentsystems/fedfunds_about.htm#:~:text=The%20Fedwire%20Funds%20Service%20business,p.m.%20on%20the%20preceding%20Sunday.

²⁶⁹ See FICC Rules, Schedule of Sponsored GC Trade Timeframes, *supra* note 19.

²⁷⁰ See Morgan Stanley Letter, *supra* note 85, at 2-3.

b. Purchases and Sales of U.S. Treasury Securities

With respect to cash transactions (*i.e.*, purchases and sales of U.S. Treasury securities), the proposal defined an eligible secondary market transaction as including:

- Any purchases and sales entered into by a direct participant and any counterparty if the direct participant (A) brings together multiple buyers and sellers using a trading facility (such as a limit order book) and (B) is a counterparty to both the buyer and seller in two separate transactions (“IDB transactions”); and
- Any purchases and sales of U.S. Treasury securities between a direct participant and a counterparty that is either (i) a registered broker-dealer, government securities dealer, or government securities broker (“broker-dealer transactions”), (ii) a hedge fund, that is any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration) (“hedge fund transactions”), or (iii) an account at a registered broker-dealer, government securities dealer, or government securities broker where such account may borrow an amount in excess of one-half of the value of the account or may have gross

notional exposure of the transactions in the account that is more than twice the value of the account (“leveraged account transactions”).

When describing the categories included within the definition, the Commission stated its belief that including this set of transactions in the eligible secondary market definition and therefore subjecting these transactions to the proposal represents an incremental first step to address potential risks arising to a U.S. Treasury securities CCA.²⁷¹ The Commission referenced recent data indicating that an estimated 68 percent of the overall dollar value of cash market transactions in U.S. Treasury securities are not centrally cleared, and an estimated 19 percent of the overall dollar value of such transactions are subject to so-called hybrid clearing (as described above).²⁷²

Regarding IDB transactions, in the Proposing Release, the Commission stated its belief that including these transactions in the definition of an eligible secondary market transaction would specifically address the potential for contagion risk associated with hybrid clearing that a number of commentators have highlighted. Hybrid clearing refers to transactions that are executed on an IDB platform in which one counterparty is a member of a CCA and submits its transaction with the IDB for central clearing, while the other counterparty is not a member of a CCA and bilaterally clears its transaction with the IDB.²⁷³ As the Commission explained in the Proposing Release, the configuration of counterparty risk presented by hybrid clearing allows the U.S. Treasury securities

²⁷¹ Proposing Release, *supra* note 14, 87 FR at 64622.

²⁷² *Id.* (citing 2021 IAWG Report, *supra* note 4, at 30; TMPG White Paper, *supra* note 13, at 12).

²⁷³ Proposing Release, *supra* note 14, 87 FR at 64622 (citing TMPG, *supra* note 13, at 12). These estimates use FR2004 data, which are reports provided to the Federal Reserve Bank of New York regarding primary dealer market activity in U.S. Government securities, covering the first half of 2017 and are based on various assumptions specified in the TMPG White Paper. *See also* FR2004, Government Securities Dealer Reports, available at <https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDZq2f74T6b1cw>.

CCA to manage the risks arising from the IDB-CCA direct participant transaction, but the U.S. Treasury securities CCA cannot manage the risks arising from the IDB's offsetting transaction with its non-member counterparty and the potential counterparty credit risk and settlement risk posed to the IDB from that trade.²⁷⁴ Thus, under the current hybrid clearing model, the U.S. Treasury securities CCA is indirectly exposed to the IDB's non-centrally cleared transaction, but it lacks the ability to risk manage its indirect exposure to this non-centrally cleared leg of the transaction. Specifically, it does not know who the ultimate counterparty of the transaction is and cannot collect margin on that transaction. This, in turn, results in margin collection at the CCP which is based upon only one transaction and has been calculated to cover this seemingly directional position, as well as an inability to net these offsetting transactions and provide the benefits of central clearing. In particular, if the IDB's non-CCP member counterparty fails to settle a transaction that is subject to hybrid clearing, such IDB may not be able to settle the corresponding transaction that has been cleared with the U.S. Treasury securities CCA due to a lack of financial resources at the IDB, which could lead the IDB to default.²⁷⁵ As part of its existing default management procedures, the U.S. Treasury securities CCA could seek to mutualize its losses from the IDB's default, which could in turn transmit stress to the market as a whole.

In the Proposing Release, the Commission reiterated its belief that membership requirements help to guard against defaults of any CCP member, as well as to protect the CCP and

²⁷⁴ See, e.g., Proposing Release, *supra* note 14, 87 FR at 64622 (citing TMPG White Paper, *supra* note 13, at 22 (noting that in a hybrid clearing arrangement, an IDB's rights and obligations to the CCP are not offset and the IDB is not in a net zero settlement position with respect to the CCP at settlement date)).

²⁷⁵ See 2021 IAWG Report, *supra* note 4, at 31; Depository Trust and Clearing Corporation, *More Clearing, Less Risk: Increasing Centrally Cleared Activity in the U.S. Treasury Cash Market*, at 5 (May 2021), available at <https://www.dtcc.com/-/media/Files/PDFs/DTCC-US-Treasury-Whitepaper.pdf> ("DTCC May 2021 White Paper").

the financial system as a whole from the risk that one member's default could cause others to default, potentially including the CCP itself. Further, contagion stemming from a CCP member default could undermine confidence in the financial system as a whole, even if the health of the CCP is not implicated, causing others to back away from participating in the market. This risk of decreased participation could be particularly problematic if the defaulting participant was an IDB, whose withdrawal from the market could impact other market participants' ability to access the market for on-the-run U.S. Treasury securities, approximately 49.7% of which trade on IDBs.²⁷⁶ Including such transactions as eligible secondary market transactions would therefore help protect against this risk by requiring that a U.S. Treasury securities CCA ensure that direct participants who are IDBs centrally clear both sides of their transactions, thereby eliminating the various aspects of potential contagion risk posed by so-called hybrid clearing.

Regarding broker-dealer transactions, in the Proposing Release, the Commission explained that the enumerated types of market participants (*i.e.*, a registered broker-dealer, government securities broker, or government securities dealer) are market intermediaries that are engaged in the business of effecting transactions in securities for the account of others (in the case of brokers) or for their own accounts (in the case of dealers).²⁷⁷ The Commission relied upon data indicating that a majority of trades in the secondary cash Treasury market now clear bilaterally and estimated that the trading volume of non-FICC members exceeds that of FICC members.²⁷⁸ The Commission stated its belief that their collective trading activity likely is responsible for a not insignificant portion of the volume of transactions involving Treasury securities and could present contagion risk to a U.S. Treasury securities CCA.

²⁷⁶ TMPG White Paper, *supra* note 13, at 32; *see* part IV.B.3.a.i *infra*.

²⁷⁷ Proposing Release, *supra* note 14, 87 FR at 64623.

²⁷⁸ *Id.* (citing TMPG White Paper, *supra* note 13, at 21; 2021 IAWG Report, *supra* note 4, at 30).

Regarding hedge fund transactions, the Commission in the Proposing Release described its intent in including transactions with hedge funds in the definition of an eligible market transaction as two-fold. First, hedge funds generally can engage in trading strategies that may pose heightened risks of potential financial distress to their counterparties, including those who are direct participants of a U.S. Treasury securities CCA. There are several characteristics of hedge fund strategies that could raise such issues, including using financial institutions that may have systemic importance to obtain leverage, employing investment strategies that may use leverage, derivatives, complex structured products, and short selling in an effort to generate returns, and relying upon strategies involving high volumes of trading and concentrated investments.²⁷⁹ The Commission stated its belief that significant hedge fund failures, resulting from their investment positions or use of leverage or both, could result in material losses at the financial institutions that lend to them if collateral securing this lending is inadequate, and that these losses could have systemic implications if they require these financial institutions to scale back their lending efforts or other financing activities generally. For these reasons, the Commission stated its belief that that if any of a hedge fund's activities, even those that are not related to the U.S. Treasury market, cause financial stress to a counterparty that is a direct participant of a U.S. Treasury securities CCA, the inclusion of a hedge fund's U.S. Treasury securities cash transactions with a direct participant in the definition of an eligible secondary market transaction should help ensure that such financial stress would not transmit to the U.S. Treasury securities CCA and through to the U.S. Treasury market.

²⁷⁹ Proposing Release, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3145 (Jan. 26, 2011), 76 FR 8068, 8073 (Feb. 12, 2011) ("Form PF Proposing Release"). The Commission adopted the hedge fund definition with some amendments thereafter. Final Rule, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3308 (Oct. 31, 2011), 76 FR 71127 (Nov. 16, 2011).

Second, the Commission relied upon the role of hedge funds in the overall U.S. Treasury market to support its proposal to include hedge fund transactions in the definition of an eligible secondary market transaction.²⁸⁰ The Commission stated its belief that hedge funds transacting in the U.S. Treasury market present a potential contagion risk to a U.S. Treasury securities CCA because, similar to the risks posed to a U.S. Treasury securities CCA by non-centrally cleared trades entered into by an IDB, non-centrally cleared transactions entered into between hedge funds and direct participants of the CCA could cause risks to the CCA in the event that the hedge fund is not able to meet its obligations to the direct participant, which could, in turn, create stress to the direct participant and through to the CCA. Therefore, the Commission stated that including the direct participant's purchase and sale transactions with hedge funds within the definition of an eligible secondary market transaction should reduce the potential for financial distress arising from the transactions that could affect the direct participant and the U.S. Treasury securities CCA.

The proposed definition of a hedge fund was described as consistent with the Commission's definition of a hedge fund in Form PF.²⁸¹ The Commission stated its belief that defining a hedge fund in a manner consistent with Form PF is reasonable, because such definition should encompass those funds that use strategies that the Commission has determined merit additional reporting to allow a better picture of the potential systemic risks posed by such

²⁸⁰ Proposing Release, *supra* note 14, 87 FR at 64624 (citing Private Funds Statistics for Q4 2021, Table 46 (July 22, 2022), available at <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q4.pdf>; Ayelen Banegas, *Sizing Hedge Funds' Treasury Market Activities and Holdings* (Oct. 6, 2021), available at <https://www.federalreserve.gov/econres/notes/feds-notes/sizing-hedge-funds-treasury-market-activities-and-holdings-20211006.htm>; see also Daniel Barth & R. Jay Kahn, *Hedge Funds and the Treasury Cash-Futures Disconnect* (Apr. 1, 2021), available at <https://www.financialresearch.gov/working-papers/2021/04/01/hedge-funds-and-the-treasury-cash-futures-disconnect/>; Hedge Fund Treasury Trading and Funding Fragility: Evidence from the COVID-19 Crisis, available at <https://www.federalreserve.gov/econres/feds/files/2021038pap.pdf>; 2021 IAWG Report, *supra* note 4, at 34; SEC Staff Report on U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock (Oct. 2020), available at https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf).

²⁸¹ 17 CFR 279.9 (Form PF Glossary of Terms).

activities.²⁸² Including transactions with such funds within the definition of an eligible secondary market transaction should help to limit the potential contagion risk that could arise from any financial distress experienced at such a fund that could, in turn, be transmitted to a direct participant of a U.S. Treasury securities CCA (and to the CCA) via any non-centrally cleared transactions. The Commission further states its belief that using a definition consistent with that of Form PF to identify transactions with a U.S. Treasury securities CCA's direct participant as part of the definition of an eligible secondary market transaction should capture transactions with entities whose default would be most likely to cause potential contagion risk to the Treasury securities CCA. For example, hedge funds' use of leverage can make them more vulnerable to liquidity shocks, which could, in turn, make them unable to deliver in a transaction with a direct participant of a U.S. Treasury securities CCA.

Regarding leveraged account transactions, in the Proposing Release, the Commission stated its belief that the inclusion of transactions with such accounts, *i.e.*, those that can take on significant amounts of leverage, within the definition of an eligible secondary market transaction should encompass transactions between direct participants of a U.S. Treasury securities CCA and a prime brokerage account, which, based on the Commission's supervisory knowledge, may hold assets of entities, such as, for example, private funds or separately managed accounts, and may use

²⁸² Final Rule, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3308 (Oct. 31, 2011), 76 FR 71127 (Nov. 16, 2011). The reporting requirements for Form PF vary based on the amount of private fund assets under management for an investment adviser registered with the Commission. For example, if an investment adviser's private fund assets under management, including with respect to hedge funds, are less than \$150 million on the last day of the most recent fiscal year, then the investment adviser is not required to file Form PF. Separately, additional reporting requirements apply to large hedge fund advisers with at least \$1.5 billion in hedge fund assets under management. *See* Form PF, Instructions 1 and 3. However, the Commission believes that including all hedge funds within paragraph (ii)(C) of the definition of an "eligible secondary market transaction" in Proposed Rule 17ad-22(a) would be consistent with its overall policy goals for central clearing in the U.S. Treasury market and ensuring that hedge fund transactions with direct participants in a U.S. Treasury securities CCA do not adversely impact the direct participant and, potentially, the CCA.

leverage that poses a risk to U.S. Treasury securities CCA and the broader financial system. The Commission further stated that by including the account, and not the entity using the account, this aspect of the proposal is targeted to the activity that could bring the most potential risk to a U.S. Treasury securities CCA and the financial system more generally.

The Commission addresses each of these particular types of transactions in parts II.B.2.b.ii through iv *infra*, after addressing more general comments with respect to cash transactions.

i. Comments Regarding Cash Clearing Generally

Several commenters supported the Commission’s proposal overall, including the cash clearing requirement.²⁸³ By contrast, other commenters opposed cash clearing generally. One commenter did not support a clearing requirement or otherwise see the current imperative for incentivizing the central clearing of cash transactions. The commenter stated that any requirement to clear cash transactions will serve to increase costs, generate operational complexities, and reduce liquidity without producing meaningful benefits to address perceived issues with respect to the cash market.²⁸⁴ The commenter explained that the increased costs would be substantial and would include, among other things, increased margin, default fund contributions, and clearing fees, as well as the costs incurred to put in place the operations, infrastructure, and standard documentation required to support central clearing.²⁸⁵ The commenter also explained that intra-day margin calls will “simply create operational burdens and costs” with no obvious benefit given that many margin calls will be met late in the day only to be returned to the posting party the next day. The commenter stated that to the extent that dealers are required to post collateral to a

²⁸³ AFREF Letter, *supra* note 33, at 2; Better Markets Letter, *supra* note 33, at 2, 6-8.

²⁸⁴ SIFMA AMG Letter, *supra* note 35, at 3.

²⁸⁵ *Id.* at 3; *see also* MFA Letter II, *supra* note 125, at 5 (regarding increased costs associated with clearing cash transactions).

covered clearing agency without compensation or to incur other costs associated with client clearing, those costs will have to be absorbed either by clients or dealers, which may reduce their capacity and further constrain liquidity.²⁸⁶ The commenter also stated that additional netting benefits for dealers are unclear as accounting rules already allow dealers to net unsettled cash transactions across all counterparties on their balance sheets.²⁸⁷ Another commenter also opposed the requirement to clear cash transactions, but supported the exclusion of money market funds from the scope of included cash transactions within the definition of an eligible secondary market transaction.²⁸⁸

In response to the commenters opposed to the inclusion of any cash transactions in the definition of an eligible secondary market transaction, the Commission disagrees. As discussed in the Proposing Release, currently, the majority of cash market transactions are not centrally cleared, which is in contrast to the market conditions in the mid-2000s when most cash transactions were centrally cleared. The fact that more than half of market activity occurs outside central clearing could represent a contagion risk to any U.S. Treasury securities CCA serving the market. Therefore, the Commission identified a set of cash transactions to include in the definition of an eligible secondary market transaction that would represent an incremental first step in the cash market, to address risks to the CCA, and identified a specific rationale with respect to each set of categories, as discussed in part II.A.2.b *supra*. Addressing these risks is a meaningful benefit in that it would ensure that a U.S. Treasury securities CCA is well positioned to understand and manage the risks posed by its participants' transactions.

²⁸⁶ SIFMA AMG Letter, *supra* note 35, at 7.

²⁸⁷ SIFMA AMG Letter, *supra* note 35, at 3.

²⁸⁸ Federated Letter, *supra* note 85, at 2.

Further, as discussed in more detail in part IV.C, although, as the commenter states, additional clearing likely would result in increased margin contributions and clearing fees, simply to account for the increased clearing volume, as well as the one-time costs regarding the institution of new contractual arrangements to access central clearing,²⁸⁹ the benefits of central clearing, as discussed in part II.A.1 *supra*, justify these costs.

The commenter's discussion regarding the operational issues of intraday margin calls does not specify the particular operational complexities that would arise, and it does not take into account the risk management benefit arising from such calls, that is, ensuring that a covered clearing agency can address the risks presented by significant intraday changes to market volatility or a member's portfolio of net unsettled positions. Without such an ability, a covered clearing agency would face potential exposure in the event of the default of a clearing member; therefore, the additional risk management that a clearing agency can accomplish using intraday margin calls must be considered.

Moreover, the Commission disagrees with the commenter's implication that this proposal needs to address the entirety of the "perceived issues" with respect to the cash market. The Commission stated in the Proposing Release that the requirement to clear eligible secondary market transactions will not, by itself, necessarily prevent future market disruptions, but that it could improve the functioning of the U.S. Treasury market.²⁹⁰ Although it may have other effects beyond the immediate requirement for U.S. Treasury securities CCAs, the requirement being adopted in this release is designed to improve the resilience of such CCAs by expanding their

²⁸⁹ The commenter also references increased default fund contributions. However, the only U.S. Treasury securities CCA serving the U.S. Treasury market does not currently maintain a default fund; therefore, the Commission disagrees that some increase in such contributions would result from the proposal.

²⁹⁰ Proposing Release, *supra* note 14, 87 FR at 64614.

ability to manage the risks arising from direct participants who currently engage in non-centrally cleared transactions away from the CCA²⁹¹ and need not solve all the issues that commentators have identified regarding the U.S. Treasury market.

By contrast, several commenters suggested that the scope of eligible secondary market transactions in the cash market be broadened. One commenter stated that the Commission should align the scope of the definition with respect to cash transactions with the proposed scope for repos, subject to certain limited exceptions for investors that trade de minimis volumes. The commenter argued that the Commission's approach with respect to cash transactions will increase costs for a specific subset of market participants (*i.e.*, hedge funds, leveraged accounts, and those using IDBs), thereby putting them at a competitive disadvantage, while failing to deliver the envisaged market-wide benefits associated with central clearing (*i.e.*, it would materially reduce the associated multilateral netting benefits, impair the risk management practices of clearing agencies, and hinder the evolution in trading protocols that can be expected from a market-wide clearing requirement).²⁹² For similar reasons, another commenter also stated that the benefits of central clearing detailed will only materialize if "a market-wide mandate is implemented" and supported defining the scope of eligible secondary market transactions for cash transactions as broadly as that proposed for repos.²⁹³ Another commenter stated that limiting the scope of the cash clearing mandate would result in unwarranted competitive disadvantages and related market distortions for some types of investors, such as hedge funds, or some types of trading platforms,

²⁹¹ *Id.*

²⁹² Citadel Letter, *supra* note 81, at 5.

²⁹³ ARB et al. Letter, *supra* note 81, at 4 (stating that the netting benefits associated with transitioning only proprietary trading firm ("PTF") transactions into central clearing are much smaller, given the substantial netting that already occurs directly with IDBs; the trading-related benefits of central clearing will only accrue to market participants if their transactions are covered by the proposed mandate; and that clearing agency resiliency will be negatively impacted if only one segment of the market is cleared).

such as anonymous trading facilities.²⁹⁴ An additional commenter stated that the proposed definition leaves out other important market participants' cash Treasury transactions that also make up a large segment of Treasury market liquidity, and that the Commission should require other market participants' cash Treasury transactions in which a direct participant is involved to be cleared, so that the benefits of central clearing that the Commission cites will accrue throughout the broader cash Treasury market.²⁹⁵ In addition, another commenter acknowledged the benefits of a comprehensive clearing requirement, but acknowledged the need for a pragmatic approach and supported the Commission's proposed requirements as a reasonable foundation to begin mandatory central clearing in this market.²⁹⁶

In response to the comments that the scope of the cash transactions that are included in the definition of an eligible secondary market transaction should be broadened, the scope is not being broadened and, in fact, is being further narrowed, as discussed further in part II.A.2.b.iii regarding hedge fund and leveraged account cash transactions (unless captured by another portion of the rule, *e.g.*, as an IDB transaction). As stated in the Proposing Release and discussed in part II.2.b *supra*, the Commission proposed a deliberate and targeted approach to clearing in the cash market in the Proposing Release, limiting the clearing requirement to specific types of entities transacting with members of a U.S. Treasury securities CCA that pose heightened risks when clearing cash market treasury transactions bilaterally. Specifically, the Commission proposed eligible secondary market transaction to be defined as, with reference to cash market transactions, a purchase or sale between a direct participant of a covered clearing agency and (A) any participant if the direct participant is an IDB; (B) a registered broker-dealer, government securities broker, or government securities

²⁹⁴ MFA Letter, *supra* note 81, at 2.

²⁹⁵ AIMA Letter, *supra* note 81, at 7.

²⁹⁶ GTS Letter, *supra* note 81, at 3-5.

dealer that is not a member of a covered clearing agency; (C) a hedge fund; or (D) a leveraged account. In each case, the Commission explained the reasoning for why such counterparties were to be included in the scope of the proposal.²⁹⁷

In response to the comments that the benefits of central clearing would only materialize with a market-wide mandate and that the targeted cash scope would fail to deliver the market-wide benefits associated with central clearing, the Commission disagrees because the increased clearing of cash transactions, targeted to address the differing risk profiles of each market segment, would still bring the benefits of central clearing to some portion of the market, even if not as widely as the scope for repo transactions, while also addressing the risks inherent in these particular market segments. The Commission does not believe that the benefits of central clearing exist only if the entire market is centrally cleared. The increased costs for certain market participants, that is, those whose transactions with direct participants of a U.S. Treasury securities CCA are included in the definition of an eligible secondary market transaction, are justified by the benefit of addressing the risks inherent in those particular transactions, and the Commission addresses each of these categories separately in parts II.A.2.b.ii through iii *infra*. Moreover, other types of cash transactions do not present the same types of risk to the CCA in terms of potential contagion risk.

ii. IDB Transactions

The proposed definition of an eligible secondary market transaction would include, among other things, any purchase or sale between a direct participant of a U.S. Treasury securities CCA and any counterparty, if the direct participant of the covered clearing agency (A) brings together multiple buyers and sellers using a trading facility (such as a limit order book) and (B) is a counterparty to both the buyer and seller in two separate transactions.

²⁹⁷ Proposing Release, *supra* note 14, 87 FR at 64622-25.

One commenter anticipated that certain other commenters would advocate for a definition of eligible secondary market transaction that would include IDB transactions and would exclude dealer-to-client over-the-counter trades, which is not what the Commission proposed.²⁹⁸ The commenter cautioned against such an “uneven” approach because it would incentivize market participants to trade bilaterally instead of using an IDB to avoid central clearing.²⁹⁹

Thus, the commenter supports the scope of the definition of an eligible secondary market transaction as proposed, that is, including both IDB transactions and the other categories of transactions set forth in the definition.³⁰⁰ The Commission agrees with the commenter that the definition, as proposed, would not incentivize market participants to trade away from IDBs to avoid central clearing because the definition of what constitutes an eligible secondary market transaction is broader than simply IDB transactions, such that avoiding IDBs alone would not be sufficient to avoid the requirement to submit eligible secondary market transactions for clearing.

In addition, commenters expressed concerns that including IDB transactions in the definition of an eligible secondary market transaction could draw trading activity away from IDBs, thereby reducing market liquidity and market stability.³⁰¹ The commenters also noted that IDBs are anonymous platforms that currently support all-to-all trading, and that the Commission has recognized that all-to-all trading would improve market structure and stability.³⁰² The commenters argued that including IDB transactions in the definition of an eligible secondary market transaction

²⁹⁸ See CME Letter, *supra* note 81, at 5.

²⁹⁹ See *id.*

³⁰⁰ See CME Letter, *supra* note 81, at 5-6 (stating the commenter’s belief that the proposal appears to have been carefully drafted to avoid encouraging market participants to trade away from IDBs).

³⁰¹ See ICI Letter, *supra* note 85, at 3, 11; MFA Letter, *supra* note 81, at 20; Tradeweb Letter, *supra* note 81, at 3-4.

³⁰² See ICI Letter, *supra* note 85, at 3, 11; MFA Letter, *supra* note 81, at 20-21; Tradeweb Letter, *supra* note 81, at 3-4.

could, therefore, hinder all-to-all trading.³⁰³ One of these commenters further argued that by discouraging market participants from trading on IDBs, the definition of an eligible secondary market transaction could limit the choices of market participants with respect to trading venues.³⁰⁴ The inclusion of IDB transactions, along with other types of transactions, would not necessarily lead to decreased liquidity and market stability or negatively impact all-to-all trading in the U.S. Treasury market. The market function provided by IDBs, that is, bringing together buyers and sellers anonymously, will continue to be desirable, even if such transactions are eligible secondary market transactions, meaning that market participants likely still would use IDBs to transact in the U.S. Treasury market. Because market participants likely would continue to transact on IDBs, the commenters' concerns regarding decreased liquidity and market stability would not materialize.

Moreover, even if some of these concerns materialize from the inclusion of IDB transactions, including them is justified as it would allow the U.S. Treasury securities CCA to better risk manage "hybrid" transactions that are currently not being submitted for central clearing.³⁰⁵ Specifically, including IDB transactions in the definition of an eligible secondary market transaction would address the potential for contagion risk associated with hybrid clearing. As explained in the Proposing Release, the configuration of counterparty risk presented by hybrid clearing allows the U.S. Treasury securities CCA to manage the risks arising from the IDB-CCA direct participant transaction, on the one hand, but the U.S. Treasury securities CCA cannot manage the risks arising from the IDB's offsetting transaction with its non-member counterparty

³⁰³ See *id.*

³⁰⁴ See MFA Letter, *supra* note 81, at 20.

³⁰⁵ The term "IDB" typically refers only to IDBs that are also ATs. See note 643 *infra*.

and the potential counterparty credit risk and settlement risk arising to the IDB from that trade.³⁰⁶ Thus, under the current hybrid clearing model, the U.S. Treasury securities CCA is indirectly exposed to the IDB's non-centrally cleared transaction, but it lacks the ability to risk manage its indirect exposure to this non-centrally cleared leg of the transaction. Specifically, it does not know who the ultimate counterparty of the transaction is and cannot collect margin on that transaction. This, in turn, results in margin collection at the CCP which is based upon only one transaction and has been calculated to cover this seemingly directional position, as well as an inability to net these offsetting transactions and provide the benefits of central clearing. In particular, if the IDB's non-CCP member counterparty fails to settle a transaction that is subject to hybrid clearing, such IDB may not be able to settle the corresponding transaction that has been cleared with the U.S. Treasury securities CCA due to a lack of financial resources at the IDB, which could lead the IDB to default.³⁰⁷ As part of its existing default management procedures, the U.S. Treasury securities CCA could seek to mutualize its losses from the IDB's default, which could in turn transmit stress to the market as a whole.

The Commission has previously stated that membership requirements help to guard against defaults of any CCP member, as well as to protect the CCP and the financial system as a whole from the risk that one member's default could cause others to default, potentially including the

³⁰⁶ See, e.g., Proposing Release, *supra* note 14, 87 FR at 64622 (citing TMPG White Paper, *supra* note 13, at 22 (noting that in a hybrid clearing arrangement, an IDB's rights and obligations to the CCP are not offset and the IDB is not in a net zero settlement position with respect to the CCP at settlement date)). Thus, the IDB is not able to net all of its positions for clearing at a U.S. Treasury securities CCA, and the IDB's positions appear to the CCA to be directional, which impacts the amount of margin that the CCA collects for the transaction.

³⁰⁷ See 2021 IAWG Report, *supra* note 4, at 31; Depository Trust and Clearing Corporation, *More Clearing, Less Risk: Increasing Centrally Cleared Activity in the U.S. Treasury Cash Market*, at 5 (May 2021), available at <https://www.dtcc.com/-/media/Files/PDFs/DTCC-US-Treasury-Whitepaper.pdf> ("DTCC May 2021 White Paper").

CCP itself.³⁰⁸ Further, contagion stemming from a CCP member default could undermine confidence in the financial system as a whole, even if the health of the CCP is not implicated. This is because the default could cause others to back away from participating in the market. This risk of decreased participation could be particularly problematic if the defaulting participant was an IDB, whose withdrawal from the market could impact other market participants' ability to access the market for on-the-run U.S. Treasury securities, approximately 49.7% of which trade on IDBs.³⁰⁹ Including such transactions within the definition of an eligible secondary market transaction would therefore help protect against this risk by requiring that a U.S. Treasury securities CCA ensure that direct participants who are IDBs centrally clear both sides of their transactions, thereby eliminating the various aspects of potential contagion risk posed by so-called hybrid clearing.

One commenter urged the Commission to consider adopting the proposal in increments based on further study, with IDB transactions as the first market segment to be included in the definition due to the distinct settlement risks associated with the IDBs' hybrid clearing model.³¹⁰ In contrast, another commenter supported adopting the proposal as drafted, arguing that to include only IDB transactions would be an uneven approach that would incentivize market participants to execute their transactions bilaterally, damaging liquidity on IDB platforms.³¹¹ Commenters identified the inclusion of IDB transactions as a targeted option to include in the definition of an eligible secondary market transaction to address contagion risk.³¹² One commenter stated that, if

³⁰⁸ See Proposing Release, *supra* note 14, 87 FR at 64623.

³⁰⁹ TMPG White Paper, *supra* note 13, at 32; section IV.B.4 (Table 1) *infra*.

³¹⁰ See SIFMA/IIB Letter, *supra* note 37, at 2-3, 16-18 (limiting the proposal to IDB transactions in the cash market would address the most salient risks that could be addressed through central clearing).

³¹¹ See CME Letter, *supra* note 81, at 5-6.

³¹² AIMA Letter, *supra* note 81, at 7; SIFMA/IIB Letter, *supra* note 37, at 16-18.

the Commission's concern is the hybrid clearing at IDBs, it would be more effective to focus on the regulation of the platforms.³¹³

The Commission agrees with all of the commenters regarding the appropriateness of Commission action to mitigate the risks associated with IDBs' hybrid clearing model. The Commission included IDB transactions in the definition of an eligible secondary market transaction in order to eliminate the potential contagion risk posed by hybrid clearing. However, the Commission disagrees with the commenters arguing in favor of limiting the scope of the definition to include IDB transactions only or taking an entirely different approach that would simply regulate IDB platforms. As discussed above, to single out IDBs (whether in the definition of eligible secondary market transaction or through another regulatory approach), without including the other cash transactions included in the definition of an eligible secondary market transaction, could incentivize market participants to trade away from IDBs, creating the potential for negative effects on market liquidity, market stability, all-to-all trading, and participant choice of trading venue. Accordingly, the Commission is adopting the definition as proposed.

Two commenters argued that transactions by registered funds that take place on an IDB should be excluded from the definition of an eligible secondary market transaction. Specifically, one commenter urged the Commission to expressly exclude registered funds (*e.g.*, mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts) from the effects of including IDB transactions in the Membership Proposal.³¹⁴ Similarly, another commenter supported an exclusion for registered money market funds.³¹⁵

³¹³ SIFMA AMG Letter, *supra* note 35, at 11.

³¹⁴ See ICI Letter, *supra* note 85, at 11.

³¹⁵ See Federated Letter, *supra* note 85, at 2.

The Commission does not agree with these commenters and is not including any exclusion for registered funds transacting on an IDB. If a fund chooses to transact on an IDB, the same potential hybrid contagion risk to the U.S. Treasury securities CCA arises as when other market participants transact on an IDB. Therefore, the Commission does not believe that such an exclusion is appropriate.

iii. Other Cash Transactions

The Commission also proposed to include certain additional categories of cash transactions of U.S. Treasury securities by the direct participants of a U.S. Treasury securities CCA in the definition of an eligible secondary market transaction subject to the Membership Proposal.

First, the Commission proposed that the definition of an eligible secondary market transaction include those cash purchase and sale transactions in which the counterparty of the direct participant is a registered broker-dealer, government securities broker, or government securities dealer. Each of these entities is a type of market intermediary that is engaged in the business of effecting transactions in securities for the account of others (in the case of brokers) or for their own accounts (in the case of dealers).³¹⁶

Commenters did not address this aspect of the definition of an eligible secondary market transaction. For the reasons stated in the Proposing Release and as discussed in part II.A.2.b *supra*, the Commission continues to believe that these portions of the definition are appropriate.³¹⁷ The Commission is therefore adopting this aspect of the exclusions as proposed.

³¹⁶ See generally TMPG, *Automated Trading in Treasury Markets* (White Paper, June 2015), available at <https://www.newyorkfed.org/TMPG/medialibrary/microsites/tmpg/files/TPMG-June-2015-Automated-Trading-White-Paper.pdf> (“TMPG Automated Trading White Paper”).

³¹⁷ Proposing Release, *supra* note 14, 87 FR at 64623.

Second, the Commission proposed to include within the definition of an eligible secondary market transaction any purchase and sale transaction between a direct participant of a U.S.

Treasury securities CCA and a hedge fund, that is any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration).

Third, the Commission proposed to include within the definition of an eligible secondary market transaction any purchase and sale transaction between a direct participant of a U.S. Treasury securities CCA and an account at a registered broker-dealer, government securities dealer, or government securities broker that either may borrow an amount in excess of one-half of the net value of the account or may have gross notional exposure of the transactions in the account that is more than twice the net value of the account. This would apply to accounts that can take on significant leverage, that is, by borrowing an amount that is more than one half of its net value or take on exposures worth more than twice the account's net value (referred to herein as "leveraged accounts").

Some commenters supported the proposed inclusion of transactions with hedge funds within the definition of an eligible secondary market transaction.³¹⁸ However, other commenters asserted that transactions with a hedge fund or a leveraged account³¹⁹ should not be within the definition of an eligible secondary market transaction.

One commenter stated that the inclusion of hedge funds within the counterparties to an eligible secondary market transaction would arbitrarily single out hedge funds' cash Treasury transactions.³²⁰ Another commenter stated that there is no data to support imposing a clearing requirement that targets hedge funds and leveraged accounts and expressed concern that a partial mandate may result in some dealers choosing to offer liquidity only in a cleared environment thereby reducing the liquidity available today to accounts in the uncleared cash market.³²¹ Another commenter stated that the inclusion of hedge funds within the counterparties to an eligible secondary market transaction would create an uneven playing field that will subject hedge funds to much higher costs than other market participants.³²²

In addition, certain commenters also raised concerns with the definition of a hedge fund in the Proposing Release, stating that because of the nature of the definition, eligible secondary market transactions would include those with firms that may (but in practice might not actually)

³¹⁸ See DTCC/FICC Letter, *supra* note 33, at 12; Better Markets Letter, *supra* note 33, *generally*; AFREF Letter, *supra* note 33, at 2-3.

³¹⁹ Commenters generally addressed the inclusion of leveraged account transactions in the definition of an eligible secondary market transaction as part of a broader discussion including both hedge fund transactions and leveraged account transactions. Therefore, the Commission is considering both types of transactions together for purposes of discussing the comments.

³²⁰ AIMA Letter, *supra* note 81, at 7.

³²¹ SIFMA AMG Letter, *supra* note 35, at 11; *see also* MFA Letter II, *supra* note 125, at 7 (regarding decreased liquidity and potentially shifting transactions away from the requirement to clear eligible secondary market transactions).

³²² MFA Letter II, *supra* note 125, at 7.

exceed the quantitative thresholds without regard to the risks that these firms actually take on, or their investment models and strategies.³²³

The Commission is not adopting proposed sections (ii)(C) and (D) of the definition of an eligible secondary market transaction with respect to hedge funds and leveraged accounts in light of questions raised by commenters regarding the inclusion of a hedge fund and a leveraged account as proposed that merit further consideration, and the Commission will continue to evaluate the issues raised to determine if any further action is appropriate with respect to transactions in the cash market. This change from the proposal allows for a more incremental approach to requiring central clearing of transactions in the cash market. However, the requirement to clear eligible secondary market transactions that are repos encompasses repos between a direct participant of a U.S. Treasury securities CCA and a hedge fund or leveraged account, as discussed in part II.A.2.a *supra*. This requirement should ensure that many of the risks posed by hedge funds, including the repo portion of a basis trade,³²⁴ would be addressed by the proposal.

Moreover, repo transactions between a direct participant of a U.S. Treasury securities CCA and a hedge fund or leveraged account would be within the scope of the definition of an eligible secondary market transaction discussed in part II.A.2.a *supra*. This inclusion is important because it addresses the risks posed by hedge fund and leveraged account repo activity in the U.S. Treasury market, which is often highly leveraged and subject to low or zero haircut.³²⁵

³²³ MFA Letter, *supra* note 81, at 18-20; AIMA Letter, *supra* note 81, at 6; SIFMA AMG Letter, *supra* note 35, at 11.

³²⁴ See note 723 *infra*.

³²⁵ See, e.g., Ayelen Banegas and Phillip Monin, *Hedge Fund Treasury Exposures, Repo, and Margining* (Sept, 8.2023), available at <https://www.federalreserve.gov/econres/notes/feds-notes/hedge-fund-treasury-exposures-repo-and-margining-20230908.html>.

iv. Comments Regarding Cash Transactions for Registered Funds

As discussed in part II.A.2.b *supra*, the definition of eligible secondary market transactions does not include transactions between direct participants of a U.S. Treasury securities CCA and registered funds. However, if a registered fund were transacting on an IDB, that transaction would be an eligible secondary market transaction because it otherwise meets the definition of such a transaction (*i.e.*, it is an IDB transaction) and not because it is a registered fund.

Certain commenters addressed cash market transactions specifically with respect to registered funds. One commenter supported an exclusion from the definition of an eligible secondary market transaction for registered funds.³²⁶ The commenter stated that applying a cash Treasury clearing mandate to funds would not promote risk reduction or enhancements to market liquidity to a degree that would justify the considerable costs and burdens to funds, which would have to build out an entire new clearing infrastructure, with such costs borne indirectly by fund investors. The commenter stated that the characteristics of typical fund cash Treasury transactions are distinguishable from the types of transactions that the Commission is seeking to capture under the mandate for risk reduction purposes, *i.e.*, those using significant leverage and/or giving rise to potential contagion risk. According to the commenter, registered funds, by contrast, invest in cash Treasury securities for purposes such as obtaining desired exposure, hedging risks associated with investments in other markets, diversifying their portfolios, and protecting capital, among other reasons. The commenter stated that these transactions are generally not linked to other leveraged strategies, and observed that funds are limited in their ability to incur leverage, both by statute (*i.e.*, Section 18 of the 1940 Act) and by SEC rules (*e.g.*, Rule 18f-4 under the 1940 Act). The commenter further asserted that as a matter of investment strategy as well, buy-side market

³²⁶ ICI Letter, *supra* note 85, at 10.

participants such as bond funds generally do not acquire significant leverage, including when investing in Treasury securities. For these reasons, the commenter asserted that including registered fund transactions in the definition of an eligible secondary market transaction would not yield additional risk reduction benefits.³²⁷

An additional commenter stated that applying this mandate to money market funds would yield minimal benefits while potentially imposing significant costs on such funds.³²⁸ The commenter stated that its money market funds do not normally utilize leverage in the cash purchase of Treasury securities, but instead are generally investing in Treasury securities on a long-term basis or are using them to hedge risks, for capital protection or for diversifying the risk in their investment portfolios. The commenter stated that these strategies are generally not linked to other leveraged strategies and therefore there is minimal contagion risk evident in these transactions. The commenter further stated that the costs of such a mandate would be significant as the commenter currently does not clear cash Treasury transactions and therefore would need to establish the technological, operational and legal frameworks that are necessary to support such a clearing mandate, meaning that any anticipated benefits of money market funds, as well as other registered funds, clearing their cash Treasury purchases would be vastly outweighed by the costs and burdens associated with such a mandate. The commenter also supported a broader exclusion for transactions with registered funds from the definition of an eligible secondary market transaction.³²⁹

As stated in the Proposing Release, the Commission identified certain categories of purchases and sales of U.S. Treasury securities that should be part of the definition of an eligible

³²⁷ ICI Letter, *supra* note 85, at 10.

³²⁸ Federated Letter, *supra* note 85, at 5.

³²⁹ *Id.*

secondary market transaction, and these categories represented an incremental first step to address potential risks arising to a U.S. Treasury securities CCA. The Proposing Release did not include transactions with registered funds as a counterparty within the definition of an eligible secondary market transaction, and the Commission does not believe that a specific exclusion for registered funds is necessary. Although a transaction with a registered fund may constitute an eligible secondary market transaction if the transaction otherwise meets the definition, it would not be because of the fact of the registered fund as a counterparty, but, rather, because the transaction met some other criteria of the definition.

The Commission understands generally that, consistent with the commenters' statements, registered funds, including money market funds, typically do not use cash transactions in U.S. Treasury securities to take on leverage, both as a matter of strategy and because of applicable regulatory requirements, and that they instead use cash transactions to obtain desired exposure, hedge risks associated with investments in other markets, diversify portfolios, or protect capital.

However, in response to the commenters that argued that registered funds' lack of leverage means that they pose no counterparty risk, the Commission believes that, to the extent that a registered fund chooses to transact on an inter-dealer broker, such transactions would pose the same type of contagion risk as other transactions executed on an inter-dealer broker. For the reasons discussed in part II.A.2.b.ii *supra*, in such cases, it is appropriate that registered funds' cash transactions, if on an IDB, would be encompassed within the definition of an eligible secondary market transaction because of the risks such transactions present as an IDB transaction and the potential for a default at the IDB to have a knock-on effect at the CCA.

v. Final Rule

For the reasons set forth in part II.A.2.b, the Commission is adopting the definition of an eligible secondary market transaction in Rule 17ad-22(a), as set forth in sections (ii)(A) and (B) of that definition with respect to IDB transactions and transactions with a registered broker-dealer, but it is not adopting the definition of an eligible secondary market transaction as set forth in sections (ii)(C) and (D) of that definition with respect to hedge fund and leveraged account transactions.

3. Other Exclusions from the Definition of an Eligible Secondary Market Transaction

Proposed Rule 17ad-22(a) would exclude transactions between direct participants of a U.S. Treasury securities CCA and certain counterparties from the definition of an eligible secondary market transaction in U.S. Treasury securities. These exclusions would apply to any purchase or sale transaction in U.S. Treasury securities or repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities between a direct participant and a central bank, a sovereign entity, or an international financial institution. A central bank would, in turn, be defined as a reserve bank or monetary authority of a central government (including the Board of Governors or any of the Federal Reserve Banks) and the Bank of International Settlements. A sovereign entity would be defined as a central government (including the U.S. Government), or an agency, department, or ministry of a central government. An international financial institution would be defined by specifying the entities, *i.e.*, (1) African Development Bank; (2) African Development Fund; (3) Asian Development Bank; (4) Banco Centroamericano de Integración Económica; (5) Bank for Economic Cooperation and Development in the Middle East and North Africa; (6) Caribbean Development Bank; (7) Corporación Andina de Fomento; (8) Council of Europe

Development Bank; (9) European Bank for Reconstruction and Development; (10) European Investment Bank; (11) European Investment Fund; (12) European Stability Mechanism; (13) Inter-American Development Bank; (14) Inter-American Investment Corporation; (15) International Bank for Reconstruction and Development; (16) International Development Association; (17) International Finance Corporation; (18) International Monetary Fund; (19) Islamic Development Bank; (20) Multilateral Investment Guarantee Agency; (21) Nordic Investment Bank; (22) North American Development Bank, and providing that the term would also include any other entity that provides financing for national or regional development in which the United States government is a shareholder or contributing member.

In addition, Proposed Rule 17ad-22(a) would also exclude transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a natural person.

Commenters expressed support for these exclusions.³³⁰ For the reasons stated in the Proposing Release, the Commission believes that these exclusions are appropriate.³³¹ The Commission is therefore adopting the exclusions as proposed.

In addition, several commenters requested an exclusion for market participants that engage in cash or repo transactions but are unable to access a U.S. Treasury securities CCA. For example, one commenter stated that this inability to access a CCA could be because of the CCA's existing rules or otherwise.³³² Another commenter stated that this inability could result from being ineligible under the CCA's existing rules, regulatory burdens, or other material impediments that prevent such access. The commenter further stated that not all market participants will be able to work with a U.S. Treasury securities CCA to determine if there are serious obstacles to access

³³⁰ SIFMA/IIB Letter, *supra* note 37, at 20; CME Letter, *supra* note 81, at 6.

³³¹ Proposing Release, *supra* note 14, 87 FR at 64625-26.

³³² See AIMA Letter II, *supra* note 115, at 4.

during the proposal's comment period and that it may take more time for any possible issues to surface.³³³ It is difficult to determine what entities will be “unable” to access central clearing and for what reasons, given that, for example, the existing rules of a CCA may change during the implementation period, *see* part III *infra*, and that different market participants may face different regulatory or other requirements that could have an effect on its access to central clearing. Therefore, such an exclusion would be overly broad and would undermine the policy goals of the requirement to clear eligible secondary market transactions. The Commission has identified a number of exclusions in this release and would consider any additional specific requests for exclusions in the future as market participants work to finalize arrangements to implement the requirements of this release.

4. Policies and Procedures Regarding U.S. Treasury Securities CCA's Monitoring of its Direct Participants' Transactions

The proposed amendments to Rule 17ad-22(e)(18)(iv)(B) would require that a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, identify and monitor its direct participants' required submission of transactions for clearing, including, at a minimum, addressing a direct participant's failure to submit transactions.

One commenter supported this aspect of the proposal.³³⁴ The commenter noted that this aspect of the proposal uses the phrase “identify and monitor,” which is an understood phrase used elsewhere in the Covered Clearing Agency Standards.³³⁵ Accordingly, the commenter anticipated that implementation of this aspect of the proposal would be similar to implementation of other

³³³ SIFMA/IIB Letter, *supra* note 37, at 21.

³³⁴ See DTCC/FICC Letter, *supra* note 33, at 21-22.

³³⁵ See DTCC/FICC Letter, *supra* note 33, at 21.

Covered Clearing Agency Standards provisions that use that phrase.³³⁶ For example, the commenter stated that it expects a U.S. Treasury securities CCA would require its direct participants to submit information regarding their U.S. Treasury transactions as well as attestations from senior officials that the participant is in compliance with its obligations.³³⁷ The commenter stated that it further expects that a U.S. Treasury securities CCA would review publicly available information (*e.g.*, information collected through FINRA’s Trade Reporting and Compliance Engine (“TRACE”) reporting) as well as information made available to it by regulatory and self-regulatory organizations.³³⁸ Additionally, the commenter stated that it expects a U.S. Treasury securities CCA would seek to identify opportunities to coordinate with market participants and self-regulatory organizations to examine collected data and identify possible instances of non-compliance.³³⁹ The commenter cautioned, however, that the ability of a U.S. Treasury securities CCA to effectively identify and monitor its direct participants’ required submission of transactions for clearing would depend on the quality and comprehensiveness of available data, and the commenter asked that the Commission continually review and improve the quality of available data.³⁴⁰ The commenter stated that it expects a U.S. Treasury securities CCA would take steps to remediate non-compliance on the part of its direct participants in a manner consistent with the Covered Clearing Agency Standards and breaches of the CCA’s own rules.³⁴¹ The commenter cautioned, however, that a U.S. Treasury securities CCA’s capacity to monitor participant non-compliance is limited because a CCA does not have authority over non-participants that may seek

³³⁶ *See id.*

³³⁷ *See id.*

³³⁸ *See id.*

³³⁹ *See id.*

³⁴⁰ *See* DTCC/FICC Letter, *supra* note 33, at 21-22.

³⁴¹ *See* DTCC/FICC Letter, *supra* note 33, at 22.

to evade the requirement to clear eligible secondary market transactions.³⁴² Therefore, the commenter asked that the Commission utilize its supervisory authority to help support any requirement to clear eligible secondary market transactions.³⁴³

Consistent with the commenter, the Commission continues to believe that such a requirement should ensure that a U.S. Treasury securities CCA has a framework in place for oversight of participants' compliance with the policies that would be adopted as part of the requirement to submit eligible secondary market transactions for clearing. Without such policies and procedures, it would be difficult for the CCA to assess if the direct participants are complying with the amendments to Rule 17ad-22(e)(18)(iv)(A) that would require the submission of eligible secondary market transactions for clearing.

The Commission continues to believe that there are a number of possible methods that a U.S. Treasury securities CCA could establish to assess its direct participants' compliance with the policies and procedures adopted pursuant to the Membership Proposal. For example, the Commission agrees with the commenter that a U.S. Treasury securities CCA could require direct participants to submit to the CCA information regarding their U.S. Treasury securities transactions or to require attestations from senior officials of the CCA's direct participants as to their submission of the required transactions and compliance with their obligations to submit such transactions. The Commission further agrees that a U.S. Treasury securities CCA also could review publicly available information and information made available to it by regulatory and self-regulatory organizations as part of its assessment of its direct participants' compliance.

³⁴² See *id.*

³⁴³ See *id.*

The Commission continues to believe that requiring a U.S. Treasury securities CCA to adopt policies and procedures that address a failure of a direct participant to submit transactions that are required to be submitted is consistent with section 17A(b)(3)(G) of the Exchange Act. That section requires that the rules of a registered clearing agency provide that its participants shall be appropriately disciplined for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, or any other fitting sanction. The Commission continues to believe that policies and procedures consistent with this aspect of the proposal should specify how a U.S. Treasury securities CCA would penalize its participants who do not submit the required transactions, whether by a particular fine or other action.

For these reasons, the Commission is adopting the requirement in Rule 17ad-22(e)(18)(iv)(B) as proposed.

5. Alternative Approaches Proposed by Commenters

As discussed in part II.A.1.a *supra*, commenters identified several methods by which the Commission could or should incentivize additional central clearing without adopting a requirement to clear eligible secondary market transactions. The Commission discusses its views on each of these in turn, including whether it has the authority to adopt certain initiatives. However, as a general matter, the Commission is not persuaded that incentivizing central clearing would be sufficient at this point, as those types of changes would not ensure that the current risks to U.S. Treasury securities CCAs are addressed. Therefore, the requirement to clear eligible secondary market transactions is necessary.

First, commenters identified the proposed amendments to Rule 15c3-3 discussed in part II.C *infra* as a method to incentivize additional central clearing.³⁴⁴ One commenter stated that the practical effect of this change would be to allow broker-dealers to use margin collected from customers to satisfy margin requirements associated with such customers' transactions, rather than using proprietary funds to finance customer margin as is the case today, and expressed its support for this amendment because it will free up broker-dealer resources by reducing the amount of proprietary funds needed to finance customer margin and therefore lower the cost of clearing, while continuing to protect customer funds.³⁴⁵ Another commenter stated that the proposed change to allow a debit under the Rule 15c3-3a customer reserve formula should incentivize central clearing of U.S. Treasury securities transactions by reducing costs.³⁴⁶ One commenter stated that this change would reduce the costs of centrally clearing U.S. Treasury securities transactions and thus incentivize more central clearing of such transactions.³⁴⁷

Second, commenters identified the proposed amendments to require U.S. Treasury securities CCAs to segregate customer positions and margin discussed in part II.C.1 *infra* as a method to incentivize additional central clearing.³⁴⁸ One commenter stated that this change would ensure that a direct participant's proprietary positions would be available to net against other proprietary positions, which would incentivize additional central clearing.³⁴⁹ An additional commenter stated that the segregation of customer positions should allow for a dealer's proprietary

³⁴⁴ SIFMA AMG Letter, *supra* note 35, at 8; SIFMA/IIB Letter, *supra* note 37, at 12; MFA Letter, *supra* note 81, at 3, 10.

³⁴⁵ MFA Letter, *supra* note 81, at 10.

³⁴⁶ SIFMA AMG Letter, *supra* note 35, at 8.

³⁴⁷ SIFMA/IIB Letter, *supra* note 37, at 12.

³⁴⁸ SIFMA AMG Letter, *supra* note 35, at 8; SIFMA/IIB Letter, *supra* note 37, at 12; MFA Letter, *supra* note 81, at 3.

³⁴⁹ SIFMA/IIB Letter, *supra* note 37, at 12, 25.

positions to be netted against that dealer's proprietary positions vis-à-vis other dealers, allowing more central clearing of U.S. Treasury securities transactions.³⁵⁰

Third, commenters identified requiring CCAs to review their access models and/or adopt particular access models or features thereof as a method to incentivize clearing, as discussed in part II.B.2 *infra*.³⁵¹

The Commission agrees that the methods identified by the commenters could incentivize and facilitate additional central clearing. The Commission therefore is adopting the amendments to Rule 15c3-3, the requirement to segregate house and customer margin, and the requirement to ensure access to central clearing, as discussed in parts II.C, II.B.1, and II.B.2 *infra* respectively. However, the Commission disagrees with these commenters that these changes alone, without also requiring that U.S. Treasury securities CCAs obligate their direct participants to submit eligible secondary market transactions for clearing, are enough. Merely incentivizing and facilitating greater central clearing is not sufficient, as those types of changes would not ensure that the current risks to U.S. Treasury securities CCAs are addressed. Therefore, for the reasons discussed in part II.2.a and b, the requirement to clear is also necessary.

Fourth, one commenter argued that another way the Commission could incentivize greater central clearing without requiring it was to require FICC to consider amending its clearing fund structure to separate initial margin from default fund requirements that can be subject to loss mutualization, which would result in capital efficiencies for bank or bank-affiliated dealers and also may allow for increased participation from counterparty types that are restricted from

³⁵⁰ SIFMA AMG Letter, *supra* note 35, at 8.

³⁵¹ SIFMA/IIB Letter, *supra* note 37, at 13; SIFMA AMG Letter, *supra* note 35, at 8; MFA Letter, *supra* note 81, at 3, 6-10.

participating in loss mutualization arrangements (*e.g.*, money market funds).³⁵² Another commenter also stated that changing the sponsored member clearing fund contribution to a pool of margin that is used in the event of a default of the underlying sponsored member would more closely align a sponsored member's exposure to potential losses in a default scenario with its own creditworthiness (*i.e.*, the defaulter pays first) and be more cost effective for sponsoring members.³⁵³ Another commenter stated that FICC must be required to separate initial margin from default fund requirements that can be subject to loss mutualization, prior to the imposition of a clearing requirement.³⁵⁴

The Commission recognizes that the particular clearing fund structure used by FICC may bring some level of capital inefficiency to banks who choose to join a CCA.³⁵⁵ However, the Commission previously has declined a commenter's suggestion to impose such a requirement.³⁵⁶ As it stated when considering a similar comment when adopting the Covered Clearing Agency Standards, the Commission acknowledges that loss mutualization and other pooling-of-resources arrangements involve tradeoffs that a CCA generally should carefully assess and balance. A CCA may be better able to manage multiple defaults in extreme conditions more efficiently using pooled resources because the pooled resources would be greater than the resources of any single defaulting participant. Further, because the arrangements are prefunded, participants can model

³⁵² SIFMA/IIB Letter, *supra* note 37, at 3.

³⁵³ ICI Letter, *supra* note 85, at 14.

³⁵⁴ MFA Letter II, *supra* note 125, at 4.

³⁵⁵ Banking regulations may result in different treatment for collateral posted as margin to a CCP if that collateral is potentially subject to loss mutualization versus collateral that is not subject to loss mutualization. Specifically, a bank has to treat potentially mutualized collateral, like clearing fund posted to FICC or, more generally, the guaranty fund posted to derivatives CCPs, differently from collateral that would be used only in the event of the specific bank member's default to the CCP. Such banking regulations are outside the scope of this rulemaking or the Commission's authority in general.

³⁵⁶ CCA Standards Adopting Release, *supra* note 10, 81 FR at 70813.

and manage the risks they face from the clearing agency while being able to take into account the amount of resources that they have provided to the clearing agency. The pooling of resources, however, can increase interdependencies among, and therefore the potential risks to, participants of the CCA. The use of loss mutualization and other pooling-of-resources arrangements generally should, to minimize systemic risk, balance the safety and soundness of the CCA against the potential for increased exposures among participants that may arise from the manner the CCA holds financial resources. For all these reasons, the Commission continues to believe that it should not impose such a requirement on CCAs, notwithstanding the potential capital efficiencies arising from a different clearing fund structure at a CCA.

Pursuant to Rule 17ad-22(e)(23), a covered clearing agency must establish, implement, maintain and enforce written policies reasonably designed to disclose, among other things, key aspects of its default rules and procedures and the risks, fees, and other material costs participants incur by participating in the covered clearing agency. The availability of these policies and procedures should allow participants to understand in advance a covered clearing agency's reliance on such resources and to consider their own ability to meet the CCA's membership obligations, including with respect to financial resources, prior to becoming members of the covered clearing agency.

Fifth, several commenters discussed facilitating cross-margining of indirect participants' transactions in U.S. Treasury securities with those in U.S. Treasury futures as a method to incentivize additional clearing.³⁵⁷ One commenter stated that the Commission should take steps to allow cross-margining of customer transactions between Treasury securities and U.S. Treasury

³⁵⁷ MFA Letter, *supra* note 81, at 11; SIFMA/IIB Letter, *supra* note 37, at 13; SIFMA AMG Letter, *supra* note 35, at 8.

futures, because the reduced margin requirements obtained through cross-margining serves an important function in increasing market liquidity through balance sheet savings and incentivizing risk reduction through hedging. The commenter also referred to the work of the G-30, which observed that wider use of cross-margining would reduce the risk that increases in initial margin requirements on the futures leg of cash-futures basis trades result in forced sales of Treasury securities, which may have contributed to selling pressures in the market in March 2020.³⁵⁸ Another commenter stated that cross-margining would lower costs for market participants by allowing them to apply margin across positions submitted for clearing through various clearinghouses. The commenter stated that this would ensure that a market participant can post margin adequate to support its positions without having to post margin in excess of regulatory requirements due to an inability to apply margin across platforms.³⁵⁹ Another commenter stated that the Commission should explore developing a framework that would allow cross margining of futures and securities transactions, and an additional commenter added that this type of framework would ensure a level playing field between direct and indirect members and noting that, unlike direct participants, clients are not permitted to cross-margin positions cleared at FICC with futures positions cleared at CME Group under FICC's current cross-margining framework, which significantly increases clearing costs for clients (depending on the trading strategies involved), discouraging clearing and creating an unlevel playing field between direct members and clients at FICC.³⁶⁰

³⁵⁸ SIFMA/IIB Letter, *supra* note 37, at 13.

³⁵⁹ MFA Letter, *supra* note 81, at 11. The commenter further stated that the Commission should ensure indirect participants also can take into account offsetting positions when calculating margin requirements. MFA Letter II, *supra* note 125, at 4.

³⁶⁰ SIFMA/AMG Letter, *supra* note 35, at 8; ARB et al. Letter, *supra* note 81, at 9.

The current cross-margining agreement between FICC and CME is part of FICC's rulebook, any changes to which have to be filed with the Commission pursuant to Section 19(b) of the Exchange Act. The Commission historically has supported and approved cross-margining at clearing agencies and 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.³⁶¹ The Commission has stated that cross-margining arrangements may be consistent with Section 17A(b)(3)(F) of the Exchange Act in that they may strengthen the safeguarding of assets through effective risk controls that more broadly take into account offsetting positions of participants in both the cash and futures markets, and promote prompt and accurate clearance and settlement of securities through increased efficiencies.³⁶² For these reasons, the Commission continues to believe that market participants can benefit from cross-margining arrangements and encourages U.S. Treasury securities CCAs to consider the potential of such benefits.

Sixth, commenters identified a number of regulations that purportedly could be changed to further incentivize central clearing that are outside the Commission's jurisdiction. For example, one commenter stated that requiring counterparties to post margin for non-centrally cleared bilateral repos through internationally agreed upon standards could level the playing field for margin requirements in Treasury repos, whether or not centrally cleared, and therefore incentivize

³⁶¹ Self-Regulatory Organizations; the Fixed Income Clearing Corporation; Order Granting Approval of Proposed Rule Change To Amend and Restate the Cross-Margining Agreement Between FICC and CME, Exchange Act Release No. 98327 (Sept. 8, 2023), 88 FR 63185, 63187 (Sept. 14, 2023); *see also* Exchange Act Release No. 90464 (Nov. 19, 2020), 85 FR 75384, 75386 (Nov. 25, 2020) (approving a second amended and restated cross-margining agreement between the Options Clearing Corp. and CME); Exchange Act Release No. 38584 (May 8, 1997), 62 FR 26602, 26604-05 (May 14, 1997) (establishing a cross-margining agreement with the Options Clearing Corp., CME, and the Commodity Clearing Corporation).

³⁶² *Id.*

market participants to centrally clear repos.³⁶³ The Commission alone cannot prescribe standards applicable to all market participants with respect to uncleared repo, and imposing requirements solely upon entities regulated by the Commission could lead to potential regulatory arbitrage. In addition, the commenter stated that FICC should have the ability to access a Federal Reserve standing repurchase facility for FICC as a systemically important financial market utility, which would (i) reduce the need for a participant-funded liquidity resources at a CCA, thereby reducing costs and incentivizing further central clearing, and (ii) mitigate the increased concentration risk of substantially increasing the Treasury transactions cleared at FICC.³⁶⁴ However, the Commission does not have the authority to provide that access.

In addition, the commenter stated that exempting a clearing member's exposure to FICC's CCLF from the Single Counterparty Credit Limits ("SCCL") or increasing the SCCL with respect to exposures to FICC, due to the larger possible CCLF exposure that bank holding companies may end up incurring, would allow market participants to clear additional transactions at FICC without risking exceeding SCCL limits.³⁶⁵ Another commenter suggested that the Commission work with other regulators to advocate for improvements to prudential rules which would have the effect of enhancing liquidity in the U.S. Treasury market (*i.e.*, the Supplementary Leverage Ratio and other capital requirements).³⁶⁶ The SCCL and the Supplementary Leverage Ratio, as well as other bank

³⁶³ SIFMA/IIB Letter, *supra* note 37, at 13.

³⁶⁴ SIFMA/IIB Letter. *supra* note 37, at 13-14.

³⁶⁵ SIFMA/IIB Letter, *supra* note 37, at 14.

³⁶⁶ SIFMA AMG Letter, *supra* note 35, at 8.

capital requirements, arise from regulations of the Board of Governors.³⁶⁷ Therefore, any changes to the SCCL and banking capital regulations are outside the Commission's jurisdiction.

One commenter suggested promoting alternatives to central clearing that could improve liquidity and strengthen the U.S. Treasury market. The commenter stated that CUSIP aggregation has been applied successfully in the past to agency mortgage-backed securities and may improve liquidity by increasing the size of certain off-the-run U.S. Treasury issuances. The commenter further stated that the U.S. Treasury could also continue to consider engaging in buybacks of existing U.S. Treasury securities as a way of improving liquidity. The commenter also stated that the Commission could further engage with the industry in discussions on how to expand all-to-all trading in secondary market cash transactions as a way to promote liquidity. Finally, the commenter stated that other recent rule proposals and enhancements to the TRACE reporting obligations for U.S. Treasury securities will in time give the Commission greater visibility into this market.³⁶⁸

In response to the comments regarding CUSIP aggregation and buyback of U.S. Treasury securities, those actions would be undertaken by either the Federal Reserve Bank of New York (or other market participants) or the U.S. Department of the Treasury, respectively.³⁶⁹ The Commission does not have the authority to conduct such actions, and these actions would not impact the overall level of central clearing in the market. In response to the comments regarding

³⁶⁷ See 12 CFR part 252 subpart H (regulations regarding SCCL); 12 CFR 217.10(c) (SLR regulation) and part 217 generally regarding bank capital requirements); *see also* Final Rule, Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations, 83 FR 38460 (Aug. 6, 2018).

³⁶⁸ SIFMA AMG Letter, *supra* note 35, at 8.

³⁶⁹ See FRBNY, Statement Regarding Aggregation of Agency Mortgage-Backed Securities Holdings (Oct. 6, 2022), available at https://www.newyorkfed.org/markets/opolicy/operating_policy_221006; 31 CFR Part 375, Marketable Treasury Securities Redemption Operations (establishing the terms and conditions by which the U.S. Department of the Treasury may redeem outstanding, unmatured marketable Treasury securities).

all-to-all liquidity, the Commission agrees that increased all-to-all trading could improve liquidity in the U.S. Treasury market and, as stated in the Proposing Release, believes that increased central clearing could, in fact, increase all-to-all trading.³⁷⁰ However, all-to-all trading does not, on its own, address the risks to CCAs that the proposal was designed to address. The Commission therefore believes that imposing requirements on CCAs to have their members centrally clear eligible secondary market transactions should proceed, regardless of the current status of all-to-all trading, to address these issues. Similarly, in response to the comments regarding TRACE reporting, the Commission does not believe that the increased reporting would address the risks to CCAs arising from current clearing practices in the U.S. Treasury market. Therefore, relying on reporting alone would not be sufficient.

Eighth, one commenter stated that the Commission should require enhanced transparency regarding FICC’s margining calculations and default management procedures. The commenter states that the proposal does not set default management standards or require disclosure of such standards. The commenter asserts that while FICC has disclosed “key aspects” of its default rules and procedures, greater transparency into these procedures, including, in particular, with respect to how FICC manages the default risk of indirect participants, would be beneficial. The commenter also stated that the proposal does not set margin requirements or require transparency into how margin requirements are set. The commenter states that with respect to both default management and margin calculations, enhanced transparency would enhance confidence in, and the resilience of, FICC, which will, in turn increase market participants’ confidence in submitting additional

³⁷⁰ Proposing Release, *supra* note 14, 87 FR at 64628; *see also* FRBNY Staff Report No. 1036, All-to-All Trading in the U.S. Treasury Market at 12-13 (Oct. 2022), *available at* https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1036.pdf?sc_lang=en (discussing how central clearing could make all-to-all trading more likely to expand in the Treasury market, while also potentially increasing the costs).

transactions for clearing.³⁷¹ Another commenter also referenced the “broad opacity” of FICC margin models and the challenges that posed for participants, stating that the participants’ inability to replicate FICC’s margin models left the direct and indirect participants as not being able to accurately predict the daily (or more) margin calls to a reasonable degree.³⁷²

The Commission’s existing rules address these issues and require transparency into default management, and margin methodology. On default management, Rule 17ad-22(e)(13) requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring the covered clearing agency’s participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedures, at least annually and following material changes thereto.³⁷³ When adopting the Covered Clearing Agency Standards, the Commission declined to prohibit or adopt specific loss allocation or default management tools suggested by commenters, relying upon the Commission’s belief that, when determining the content of its policies and procedures with respect to default management, each CCA must have the ability to enhance its policies and procedures to meet the evolving challenges and risks in the securities market that the CCA serves.³⁷⁴ For these reasons, the Commission continues to believe that it should not set particular default management procedures for CCAs.

³⁷¹ MFA Letter, *supra* note 81, at 11-12; *see also* MFA Letter II, *supra* note 125, at 5.

³⁷² SIA Partners Comment, *supra* note 52, at 18; *see also id.* at 74-75.

³⁷³ 17 CFR 240.17ad-22(e)(13).

³⁷⁴ CCA Standards Adopting Release, *supra* note 10, 81 FR at 70829.

In addition, Rule 17ad-22(e)(6) requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system.³⁷⁵ Thus, CCAs are required to develop policies governing how they calculate margin. In addition, under the amendments to Rule 17ad-22(e)(6) being adopted in this release, CCAs will be obligated to have policies and procedures to calculate house margin separately from customer margin.

Further, both default management and margin calculation generally constitute material aspects of the operations of a CCA, meaning that they should be considered stated policies, practices, or interpretations under Exchange Act Rule 19b-4.³⁷⁶ As such, they are subject to the filing obligations applicable to SROs under Section 19(b) of the Exchange Act. This means that the default management processes and margin methodologies are described in SRO rule filings upon which market participants may comment and that the Commission must review and approve. CCAs have adopted rules on these topics pursuant to the SRO rule filing process.³⁷⁷ The filing

³⁷⁵ 17 CFR 240.17ad-22(e)(6).

³⁷⁶ 17 CFR 240.19b-4(a)(6)(i).

³⁷⁷ *Regarding default management, see, e.g.,* FICC Rule 4, sections 6, 7, 7a, and 7b (addressing application of clearing fund deposits and other Amounts to defaulting members' obligations, loss allocation waterfall, corporate contribution, and withdrawal from membership in the event of a loss allocation); FICC Rule 3A, sections 12, 15, and 16 (addressing loss allocation in the Sponsored Service and the insolvency of either a sponsoring or sponsored member), *supra* note 19; Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Amend the Loss Allocation Rules and Make Other Changes, Exchange Act Release No. 83970 (Aug. 28, 2018). *Regarding margin methodologies, see e.g.,* FICC Rule 4, section 1b (setting forth the GSD unadjusted margin portfolio amount) and section 2a (describing the intraday supplemental required fund deposit), in conjunction with Rule 1 (defining the various components of the margin methodology, including, among other things, the VaR Charge, the Backtesting Charge, and the Margin Liquidation Adjustment Charge), *supra* note 19; *see also* Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Implement Changes to the Required Fund Deposit Calculation in the Government Securities Division Rulebook, Exchange Act Release No. 83362 (June 1, 2018), 83 FR 26514 (June 7, 2018).

obligations under Section 19(b) of the Exchange Act provide transparency into the covered clearing agencies' default management processes and margin methodologies.

Second, in addition to the aforementioned obligations under the Covered Clearing Agency Standards specific to default management and margin, Rule 17ad-22(e)(23) also imposes a set of requirements related to transparency and disclosure. Specifically, a CCA is obligated to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures, and providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the CCA.³⁷⁸ In addition, a CCA must produce a comprehensive public disclosure that describes its material rules, policies, and procedures regarding its legal, governance, risk management, and operating framework, accurate in all material respects at the time of publication, that includes, among other things, a standard-by-standard summary narrative for each applicable standard set forth in paragraph (e)(1) through (23) of the Covered Clearing Agency Standards section with sufficient detail and context to enable a reader to understand the CCA's approach to controlling the risks and addressing the requirements in each standard.³⁷⁹ Thus, each CCA issues a public document designed to address each standard, including those with respect to fees, default management, and margin.³⁸⁰ In addition, CCAs provide a variety of additional tools to assist their participants in understanding their margin obligations, such as descriptions of the components, including their

³⁷⁸ 17 CFR 240.17ad-22(e)(23)(i) and (ii).

³⁷⁹ 17 CFR 240.17ad-22(e)(23)(iii).

³⁸⁰ See, e.g., FICC Disclosure Framework, available at https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf.

calculations, and margin calculators that can be used to estimate margin requirements based on potential changes to a participant's portfolio.³⁸¹

Accordingly, because of the existing framework applicable to transparency, the Commission disagrees that enhanced transparency into margining calculations and default management procedures is necessary or that it would meaningfully incentivize greater clearing. However, the Commission encourages market participants and CCAs to engage regarding the existing tools and potential additional resources that could be provided to better assist market participants at understanding potential margin obligations.

Finally, one commenter encouraged the Commission to consider whether proposal should specifically require FICC to establish rules ensuring that fees charged by direct participants are transparent and reasonable.³⁸² Section 17A(b)(3)(E) of the Exchange Act requires that the rules of a clearing agency do not impose any schedule of prices, or fix rates or other fees, for services rendered by its participants. In light of this statutory provision, a rule such as that suggested by the commenter would not be appropriate.

For all these reasons, the Commission disagrees with commenters that would support not requiring the clearance of eligible secondary market transactions. The Commission believes that requiring direct participants of U.S. Treasury securities CCAs to clear their eligible secondary market transactions is essential to improving risk management at U.S. Treasury securities CCAs

³⁸¹ See, e.g., FICC Government Securities Division, Overview of the Clearing Fund Methodology (Oct. 2023), available at <https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/GSD-Clearing-Fund-Methodology-Overview-October-2023.pdf>; Comment Letter from FICC re: SR-FICC-2020-017 and SR-FICC-2020-804, available at <https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8451684-229787.pdf> (describing the different capabilities provided at FICC to enable direct participants to determine their margin requirements, including, but not limited to a calculator that provides functionality to direct participants to enter “what if” position data and recalculate their VaR Charge to determine margin impact pre-trade execution and to see the impact to VaR if specific transactions are executed or to anticipate the impact of an increase or decrease to a current clearing position).

³⁸² MFA Letter, *supra* note 81, at 11.

(including contagion risk) and to obtaining the benefits of central clearing in the U.S. Treasury market, as discussed in part II.A.1.a *supra*. As discussed in more detail in parts III and IV *infra*, the Commission does not believe that further study is necessary, but believes that, as discussed in more detail in part III, a phased implementation schedule for the requirements discussed in part II, beginning with some of the items identified as incentives to central clearing, should address commenters' concerns that the necessary market infrastructure is not in place to support the requirement to clear eligible secondary market transactions.

B. Additional Changes to Covered Clearing Agency Standards

The Commission also proposed additional changes to the Covered Clearing Agency Standards, designed to address the likely increase in the volume of U.S. Treasury securities transactions submitted for central clearing resulting from the proposed requirement that direct participants of a U.S. Treasury securities CCA submit eligible secondary market transactions for clearance and settlement. The Commission is adopting these additional changes, for the reasons discussed in more detail below.

1. Netting and Margin Practices for House and Customer Accounts

The proposed amendments to Rule 17ad-22(e)(6)(i) would require a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin amounts from a direct participant for its proprietary U.S. Treasury securities positions separately and independently from margin calculated and collected from that direct participant in connection with U.S. Treasury securities transactions by an indirect participant that relies on the services provided by the direct participant to access the covered clearing agency's payment, clearing, or settlement facilities. This rule would prohibit a U.S. Treasury securities CCA from netting customer and proprietary positions.

In the Proposing Release, the Commission stated it believed that the separation of house and customer positions could reduce the potential risk to the U.S. Treasury securities CCA arising from such transactions. Such changes should allow a U.S. Treasury securities CCA to better understand the source of potential risk arising from the U.S. Treasury securities transactions it clears and potentially further incentivize central clearing.³⁸³

Importantly, the amendment to Rule 17ad-22(e)(6)(i) would not require that a CCA's direct participant collect a specified amount of margin from its customers or determine customer margin in a particular manner, such as on a gross basis; the calculation and collection of margin between a CCA direct participant and its customers would be left to other applicable regulations and, to the extent applicable, bilateral negotiation between the member and its customer. As the Commission stated in the Proposing Release,³⁸⁴ the amendments to Rule 17ad-22(e)(6)(i) would, in this way, require policies and procedures that closely resemble the calculation, collection, and holding of margin for listed options.³⁸⁵ When considering and adopting the Covered Clearing Agency Standards, the Commission noted that customer segregation can be achieved through such an omnibus account structure, where all collateral belonging to all customers of a particular member is commingled and held in a single account segregated from that of the member,³⁸⁶ which is

³⁸³ Proposing Release, *supra* note 14, 87 FR at 64633.

³⁸⁴ Proposing Release, *supra* note 14, 87 FR at 64634.

³⁸⁵ Currently, the covered clearing agency that clears and settles listed options transactions holds margin for customer trades separately from the proprietary trades of the submitting participant in an omnibus account. See Options Clearing Corp. Rules 601(c) and (d), available at https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf ("OCC Rules"). This approach is also similar to the approach used for futures customers. See 17 CFR 1.22 and Advanced Notice of Proposed Rulemaking, Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, 75 FR 75162, 75163 (Dec. 2, 2010) (describing the futures model).

³⁸⁶ See Proposing Release, *supra* note 14, 87 FR at 64634 (discussing CCA Standards Proposing Release, *supra* note 8, 79 FR at 29547; CCA Standards Adopting Release, *supra* note 10, 81 FR at 70832-33).

consistent with the practice at the clearing agency for listed options and this amendment to Rule 17ad-22(e)(6)(i).

Commenters generally supported the proposed amendment to Rule 17ad-22(e)(6)(i).³⁸⁷ One commenter agreed that this amendment would further the risk management benefits associated with central clearing and help avoid a direct participant's disorderly default because FICC would have a more holistic view of the market than currently available, and that because a direct participant's margin would be calculated, collected and held separately and independently than that of its customers, the direct participant's trades with its customers can be netted against the direct participant's trades with other direct participants.³⁸⁸ One commenter stated that the proposed changes with respect to risk management requirements would facilitate the proposal's goals of increased central clearing, and that it would also appropriately assign the risk of centrally cleared customer U.S. Treasury securities transactions to the customer.³⁸⁹

However, commenters also raised several additional issues with respect to the separation of house and customer margin that the Commission will address below.

First, several commenters argued that this rule should also prohibit the use of separate customer margin for any other purpose, including loss mutualization (*i.e.*, when a clearing agency uses non-defaulting customers' funds in the event of a default, thereby "mutualizing" the loss).³⁹⁰

³⁸⁷ ICE Letter, *supra* note 33, at 3; DTCC/FICC Letter, *supra* note 33, at 25; ICI Letter, *supra* note 85, at 25-26; SIFMA/IIB Letter, *supra* note 37, at 25-26; Tradeweb Letter, *supra* note 81, at 3; AIMA Letter, *supra* note 81, at 8; AFREF Letter, *supra* note 33, at 5; SIFMA AMG Letter, *supra* note 35, at 8.

³⁸⁸ AIMA Letter, *supra* note 81, at 8.

³⁸⁹ SIFMA/IIB Letter, *supra* note 37, at 25.

³⁹⁰ SIFMA/IIB Letter, *supra* note 37, at 26-27; ICI Letter, *supra* note 85, at 19 (supporting strong protections for funds in whatever models FICC chooses to adopt, including LSOC protections, and stating that customer funds must be identified as fund assets and have the benefit of customer treatment); AIMA Letter, *supra* note 81, at 8 (stating that the Commission should specify that client initial margin should not be included as part of a clearing agency's default waterfall and subject to loss mutualization); ARB et al. Letter, *supra* note 81, at 8

Another commenter stated that prohibiting the use of customer margin for loss mutualization would mitigate higher risk-weighted assets under certain bank capital rules and may also facilitate clearing for market participants that are subject to restrictions regarding exposure to loss mutualization.³⁹¹

What the commenters seek is akin to the requirements applicable to derivatives clearing organizations clearing swaps, that is, the “legally segregated, operationally commingled” (“LSOC”) model, which, as the Commission stated in the Proposing Release, differs from the requirements proposed in Rule 17ad-22(e)(6)(i).³⁹² Under such an approach, customer collateral may be held in one combined account and commingled, but in the event of a customer default, the collateral of non-defaulting customers would not be available to cover any losses attributable to the defaulting customer (*i.e.*, they would be legally separated from the collateral of the defaulting customer and not available for loss mutualization).³⁹³ As discussed in the Proposing Release, the Commission previously has declined to require such an approach for covered clearing agencies, preferring to allow each covered clearing agency to determine the method that works best for the products it clears and markets it serves.³⁹⁴ When discussing that conclusion, the Commission also

(“in no event should margin posted for client positions be available for use as part of a clearing agency’s default waterfall”); MFA Letter, *supra* note 81, at 7 (“it is crucial that indirect participants are able to post margin on a segregated basis such that their clients are not subject to the credit risk of others (and, likewise, that their funds are not subject to loss mutualization”); *see also* SIFMA AMG Letter, *supra* note 35, at 12-13 (“it will be difficult to support expanding cleared trading in U.S. Treasury securities until we have a framework which ensures customers can access clearing solutions where their margin and collateral will be adequately protected, including from loss mutualization by the clearing agency”).

³⁹¹ Letter from Ann Battle, Senior Counsel, Market Transitions, International Swaps and Derivatives Association, Inc., at 2 (Dec. 27, 2022) (“ISDA Letter”).

³⁹² Proposing Release, *supra* note 14, 87 FR at 64634 (discussing 17 CFR 22.15).

³⁹³ *See, e.g.*, Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336, 6339 (Feb. 7, 2012) (describing the LSOC approach and adopting final rules for this approach).

³⁹⁴ *See* Proposing Release, *supra* note 14, 87 FR at 64634 (discussing CCA Standards Adopting Release, *supra* note 10, 81 FR at 70832).

noted that this type of segregation does not occur at the CCP level under the current market structure for cash securities and listed options, and that customer positions and funds in the cash securities and listed options markets are eligible for protection under SIPA, which is not the case for futures and cleared swaps.³⁹⁵

The Commission continues to believe that it would not be appropriate to require an LSOC model for U.S. Treasury security CCAs, because customer positions and funds in the market for cash securities and listed options would be eligible for protection under SIPA, unlike in other markets which use an LSOC model. However, a U.S. Treasury securities CCA may choose to offer such a model, based upon what works best for both direct and indirect participants or to satisfy other regulatory obligations. In practice, U.S. Treasury securities CCAs seeking to provide services that would allow broker-dealers to rehypothecate customer margin to the CCA, as discussed further in part II.C.2 *infra*, would, consistent with that flexibility, choose to adopt practices that would ensure that customer funds can be used only for a loss arising from customer activity and could not be used for loss mutualization. Thus, adopting the changes described in section II.C.2 below should also result in U.S. Treasury securities CCAs incorporating access models that provide for the type of segregation requested by the commenters.

Another commenter argued that the Commission should consider additional changes that would compel FICC to require that all margin requirements related to customer positions be satisfied by those customers, to appropriately allocate risk to those customers and lower barriers to participation in central clearing for customers by direct participants who otherwise may not be able to submit margin on behalf of their customers.³⁹⁶ The requirement to collect, calculate, and hold

³⁹⁵ *Id.*

³⁹⁶ SIFMA/IIB Letter, *supra* note 37, at 26 (analogizing to the CFTC requirement that DCOs collect at least 100% of margin to cover customer positions, *see* 17 CFR 39.13(g)(8)).

customer margin separate from proprietary margin should ensure that, at the CCA level, the risks arising from customer clearing are sufficiently margined to protect the CCA from the exposure arising from customer clearing. In the event that a direct participant of the CCA is not able to submit margin on behalf of its customers, such participants could elect to take advantage of the amendments to Rule 15c3-3, as discussed in part II.C.2 *infra*, regarding Rule 15c3-3, which would require the participant to collect 100% customer margin in order to be able to onward post the margin.

An additional commenter described the proposed rule as requiring customers to be margined individually and requiring FICC to collect margin even where a member's overall customer position is netted, which would "exponentially" increase the margin requirement on all those involved in the U.S. Treasury market.³⁹⁷ The Commission disagrees that the proposed amendments to Rule 17ad-22(e)(6)(i) would require customers to be margined individually or that FICC would be required to collect margin even where a participant's overall position is netted. As discussed in the Proposing Release, the proposed changes would require that a U.S. Treasury securities CCA calculate, collect, and hold margin for positions in U.S. Treasury securities transactions of a direct participant in a U.S. Treasury securities CCA separately from those of customers or other indirect participants that rely on the direct participant to access the covered clearing agency's payment, clearing, or settlement facilities, but this does not mandate the calculation of margin for individual customers, that is, on a gross basis for each customer.³⁹⁸ A U.S. Treasury securities CCA would have the discretion to collect a single netted amount for each

³⁹⁷ IDTA Letter, *supra* note 66, at 4.

³⁹⁸ Proposing Release, *supra* note 14, 87 FR at 64634.

clearing member's customer account as a whole, that is, netting each customer's margin against that of other customers within the overall customer account.³⁹⁹

The commenter also discusses the impact of this purported gross margining on small and mid-size broker-dealers who are disproportionately affected by FICC's Excess Capital Premium ("ECP") charge, which is a margin add-on that collects a premium when a member's VaR charge exceeds the member's Net Capital, net assets or equity capital (as applicable to that member based on its type of regulation).⁴⁰⁰ The commenter explained the potential impact of the ECP charge in conjunction with FICC's Sponsored Service, stating that "the combination of gross margining and ECP currently in use under the Sponsored Model, and what is prescribed in the Proposed Rule, effectively prevents smaller and middle market broker dealers from materially participating in the Treasury market."⁴⁰¹ The commenter states that the potential effect of the ECP charge would be exacerbated when customer/institutional counterparty margin is included in the calculation, and the surcharge prevents smaller independent broker-dealers from sponsoring institutional counterparties/customers.⁴⁰² The commenter states that the proposal must be changed to ensure that the combined effect of gross margining and the ECP does not excessively burden smaller, middle-market broker dealers and their institutional investor customers.⁴⁰³ The commenter's concerns regarding the interplay between purported required gross margining and the ECP charge rests on the assumption that gross margin is required under the proposal, which, as discussed in the prior paragraph, is not the case. In addition, FICC recently has indicated that it intends to make

³⁹⁹ *Id.*

⁴⁰⁰ IDTA Letter, *supra* note 66, at 4; *see also* FICC Rule 4, section 14, *supra* note 19.

⁴⁰¹ IDTA Letter, *supra* note 66, at 5.

⁴⁰² IDTA Letter, *supra* note 66, at 5.

⁴⁰³ IDTA Letter, *supra* note 66, at 6.

available client clearing models that do not require gross margin, consistent with its current offerings.⁴⁰⁴ Therefore, the Commission does not believe that the proposal needs to be changed to address this issue. With respect to the ECP charge on its own, the Commission is not taking any action with respect to the ECP charge as part of adopting these new requirements. The ECP charge is part of FICC's existing rulebook, and any change to that rulebook would be made pursuant to the proposed SRO rule change process under Section 19(b).⁴⁰⁵

Another commenter stated that the Commission should encourage FICC to hear and consider input from indirect participants regarding potential changes to fee and governance models.⁴⁰⁶ The Commission has adopted a requirement that registered clearing agencies must establish, implement, maintain and enforce written policies and procedures reasonably designed to solicit, consider, and document its consideration of the views of participants and other relevant stakeholders of the registered clearing agency regarding material developments in its governance and operations on a recurring basis.⁴⁰⁷ Requiring these policies and procedures should ensure that FICC considers input from indirect participants regarding potential changes to fee and governance models.

For the reasons discussed above, the Commission is therefore adopting the amendments to Rule 17ad-22(e)(6)(i) as proposed.

⁴⁰⁴ See DTCC 2023 White Paper, *supra* note 107, at 6 (discussing that the proposal would allow the option to calculate and collect margin associated with customer activity on a gross or net basis depending on the client clearing model selected by the member and stating that FICC would offer options via different access models that would allow those parties to balance the benefits of netting and segregation in different ways).

⁴⁰⁵ 15 U.S.C. 78s(b); *see also* 15 U.S.C. 78s(c).

⁴⁰⁶ AIMA Letter, *supra* note 81, at 8.

⁴⁰⁷ Adopting Release, Clearing Agency Governance and Conflicts of Interest, Exchange Act Release No. 98959 (Nov. 16, 2023), 88 FR 84454 (Dec. 5, 2023) (adopting Rule 17ad-25(j)).

2. Facilitating Access to U.S. Treasury Securities CCAs

Proposed Rule 17ad-22(e)(18)(iv)(C) would require that a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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, which policies and procedures the U.S. Treasury securities CCA's board of directors reviews annually. In the Proposing Release, the Commission explained that this provision does not prescribe specific methods for market participants to obtain indirect access to a U.S. Treasury securities CCA.⁴⁰⁸

In the Proposing Release, the Commission stated its understanding that indirect participants may have significantly different preferences with respect to how they access and obtain clearing services from direct participants of U.S. Treasury securities CCAs. The Commission explained that this proposed requirement is intended to help ensure that all U.S. Treasury security CCAs review their indirect access models and ensure that they facilitate access to clearance and settlement services in a manner suited to the needs and regulatory requirements of market participants throughout the U.S. Treasury securities market, including indirect participants.⁴⁰⁹

a. Comments Supporting the Commission's Proposed Rule

Commenters generally supported the Commission's attention to the need for appropriate access to the U.S. Treasury securities CCA,⁴¹⁰ and several commenters specifically agreed that the Commission should not prescribe any particular model. One commenter cautioned that dictating a single model of clearing would close off clearing to many market participants, force indirect

⁴⁰⁸ Proposing Release, *supra* note 14, 87 FR at 64635.

⁴⁰⁹ *Id.*

⁴¹⁰ MFA Letter, *supra* note 81, at 5.

participants to bear additional clearing costs, increase concentration, reduce competition, and negatively impact market liquidity.⁴¹¹ In addition, another commenter stated that clearing agencies should have flexibility to innovate in this area.⁴¹² Another commenter stated that it supported the proposal's approach of allowing clearing agencies to engage on potential reforms directly with affected market participants via the clearing agencies' existing rulemaking processes, particularly given the many risks involved and given that various models may be appropriate for different firms and different situations.⁴¹³

Another commenter asked the Commission to retain optionality in access models for U.S. Treasury securities CCAs, because all access models have costs and benefits and different access models may be appropriate for different market participants or commercial arrangements. The commenter agreed with the Commission that neither the Commission nor the rulebook of a U.S. Treasury securities CCA should mandate a single approach to access or require that direct participants that clear for indirect participants offer all possible access models. The commenter stated that a U.S. Treasury securities CCA should provide the flexibility necessary to allow market participants to match access models with optimal use cases, which would encourage maximum market participation from a diverse group.⁴¹⁴

The Commission agrees with these commenters regarding the need for flexibility in a U.S. Treasury securities CCA's access models. These CCAs should be able to develop models that meet the needs of different market participants, and they should not mandate a single approach to access or require that direct participants that clear for indirect participants offer all possible access

⁴¹¹ DTCC/FICC Letter, *supra* note 33, at 14, 18.

⁴¹² ICE Letter, *supra* note 33, at 3.

⁴¹³ ISDA Letter, *supra* note 391, at 3.

⁴¹⁴ SIFMA/IIB Letter, *supra* note 37, at 23.

models. When considering whether its models meet the needs of different market participants, a U.S. Treasury securities CCA generally should consider certain topics related to its access models, such as their sustainability, the need for additional models or revisions, and potential applicability of models used in other markets, as part of the CCA's consideration of its compliance with this proposed rule. Many commenters also expressed that the Commission should impose additional requirements regarding access to a U.S. Treasury securities CCA. These comments are discussed in the following parts II.B.2.b and c.

**b. Comments Regarding the Commission's Authority to Require a
CCA to Accept Done Away Transactions**

Several commenters stated that the Commission should require that a U.S. Treasury securities CCA obligate its members to accept done-away transactions and/or that the Commission should prohibit anticompetitive practices at CCPs, including prohibiting clearing members from requiring clients to bundle execution and clearing.⁴¹⁵ The commenters argued that the Commission had the statutory authority to implement such a requirement. First, the commenters stated that "since a clearing requirement cannot be implemented in the Treasury market unless the Commission ensures that both direct and indirect participant have a way to access a clearing agency, the two topics are inseparable and the Commission can rely on the statutory authority underlying the clearing requirement in order to address related access issues, including promoting the prompt and accurate clearance and settlement of Treasury securities."⁴¹⁶ Second, the commenters stated that Section 17A of the Exchange Act grants the Commission broad authority to improve access and competitive practices at a clearing agency. The commenters identified the

⁴¹⁵ See, e.g., ARB et al. Letter, *supra* note 81, at 7; MFA Letter II, *supra* note 125, at 3-4; see also Citadel Letter, *supra* note 81, at 7.

⁴¹⁶ ARB et al. Letter, *supra* note 81, at 7; see also Citadel Letter, *supra* note 81, at 7.

Commission's authority to adopt rules for clearing agencies that are necessary or appropriate in the public interest or otherwise in furtherance of the purposes of this chapter, noting that the purposes of Section 17A include maintaining fair competition among brokers and dealers and scrutinizing clearing agency rules to ensure they do not permit unfair discrimination among participants in the use of the clearing agency and do not impose any burden on competition not necessary or appropriate.⁴¹⁷ Another commenter stated that the Commission has the authority in Section 17A to prohibit anticompetitive practices at all CCAs.⁴¹⁸

Similarly, one commenter asserted that requiring a direct participant that offers clearing services to indirect participants to accept those indirect participants' done away transactions would be consistent with Exchange Act Section 17A, 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. The commenter also suggested, at a minimum, that 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.

The commenters cited several provisions of Section 17A in support of their views. First, several commenters referenced language in Section 17A(a)(1), which sets forth the Congressional findings underpinning Section 17A. Specifically, Congress found that, inefficient procedures for

⁴¹⁷ See Citadel Letter, *supra* note 81, at 7; ARB et al. Letter, *supra* note 81, at 6.

⁴¹⁸ AIMA Letter, *supra* note 81, at 6.

clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors, and that the linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors. These findings, including the reference to “unnecessary costs,” do not provide the Commission with authority to adopt rules requiring CCAs to impose particular requirements on their direct participants regarding the direct participants’ business models. Instead, they represent Congress’ findings about the consequences of the situation at the time Section 17A was adopted in 1975.

Second, the commenters relied upon language in Section 17A(a)(2) setting forth the Congressional direction to the Commission regarding a national system for clearance and settlement. This direction instructs the Commission to take into account, among other things, the maintenance of fair competition among brokers and dealers when facilitating the establishing of a national system for the prompt and accurate clearance and settlement of securities transactions.

Third, commenters relied upon language in Section 17A(b)(3)(F) and (I). These provisions set forth certain requirements for a clearing agency’s rules that must be met in order for the Commission to register the clearing agency. In the portions cited by commenters, Section 17A(b)(3)(F) states that the clearing agency’s rules should be, among other things, designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest, and that they should not be designed to permit unfair discrimination among participants in the use of the clearing agency. Section 17A(b)(3)(I) states that the clearing

agency's rules should not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

The type of requirement sought by commenters differs from the requirement to clear eligible secondary market transactions, in that the requirement to clear eligible secondary market transactions relates to transactions that the direct participant already has determined to enter into, based on its own business model.⁴¹⁹ It is not requiring the direct participant to engage in particular transactions or to offer particular business models. By contrast, the commenters' support for a prohibition on anti-competitive practices or a requirement to accept done-away transactions would require clearing agencies to, in turn, require their direct participants to transact with their customers in specific ways and limit their ability to offer certain types of pricing services. As discussed in the Proposing Release, the current client clearing models in place at FICC allow for the submission of done-away transactions and allows non-FICC entities to access the CCA through multiple direct participants, but do not require any direct participant to submit done-away transactions on behalf of other market participants.⁴²⁰ Therefore, the Commission disagrees that the failure to require the submission of done-away transactions necessarily constitutes "unfair discrimination," as discussed in Section 17A(b)(3)(F). Moreover, in order to encourage market participants to provide services to enable indirect access to central clearing, the Commission believes it is best not to remove the ability of a direct participant of a U.S. Treasury securities CCA to determine what risk it will take with respect to guaranteeing transactions to the CCA. In addition, the Commission would not agree with the commenter that, at this time, the current access

⁴¹⁹ Specifically, the definition of an eligible secondary market transaction would simply identify various types of transactions but would not favor or require one over another.

⁴²⁰ Proposing Release, *supra* note 14, 88 FR at 64635.

models offered by the existing U.S. Treasury securities CCA constitute a burden on competition that is not necessary or appropriate, as discussed in Section 17A(b)(3)(I).

More generally, the Commission disagrees that it should impose a particular access model at this time. The Commission is adopting a number of changes with regard to the method by which CCAs will provide services to the U.S. Treasury market, including the segregation of house and customer margin and the potential ability to use Rule 15c3-3 to rehypothecate customer margin to the CCA to meet margin requirements, and regarding the CCA's obligations with respect to ensuring access. These changes will present both new obligations, but also potentially new business opportunities, for existing direct participants of the U.S. Treasury securities CCA. It is appropriate to allow the U.S. Treasury market to take these new requirements into account, before determining that additional access models are needed. Currently, FICC's models do allow for done-away transactions, and the Commission therefore disagrees that an additional model is a prerequisite to the requirement to clear eligible secondary market transactions.⁴²¹

Finally, a commenter also stated that in order to satisfy the proposal's principles-based access requirement, a clearing agency should have to demonstrate that, for each clearing model it considers necessary to offer to satisfy that access standard, the clearing agency is clearing a material volume of transactions through that model (*i.e.*, if permitting done away clearing is necessary for the clearing agency to satisfy the proposal, then the clearing agency must demonstrate that material volume of done away clearing is actually taking place).⁴²² The Commission agrees with the commenter that the CCA generally should consider the volumes and

⁴²¹ In addition, the Commission notes that any additional model would have to be consistent with Section 17A(b)(3)(E), which requires that the rules of a registered clearing agency not impose any schedule of prices, or fix rates or other fees, for services rendered by its participants.

⁴²² MFA Letter, *supra* note 81, at 9.

proportion of the market that are being centrally cleared through different access models as part of the CCA's consideration of whether its access models are meeting the needs of the market.

c. Other Comments Regarding Access

Other commenters supported additional Commission requirements regarding customer clearing models, particularly with respect to done-away transactions. One commenter stated that the Commission needs to be more prescriptive in directing covered clearing agencies on how they design their access models, disagreeing with the amount of discretion left to the clearing agency and its board. The commenter stated that a successful clearing model must also facilitate and incentivize the clearing of "done away" transactions, which will require changes to incentives so that clearing brokers are compensated for facilitating this activity. The commenter identified "the only viable path" to a clearing requirement as the Commission's issuing a detailed rulemaking establishing a common clearing model and standards which must be met by any U.S. Treasury securities CCA, including FICC.⁴²³

The Commission addressed similar comments in the discussion in part II.B.2.b *supra*. As discussed there, the Commission is not prescribing particular access models. The Commission agrees with commenters that a workable done-away model will be critical to this market, to accommodate the increased central clearing that would result from implementation of this rule, and encourages FICC and other market participants to consider how to offer and price the currently available models to ensure that indirect participants can access central clearing.

One commenter stated that the Commission should adopt more robust and direct measures to ensure fair and open access, specifically to make sure that market participants have sufficient

⁴²³ SIFMA AMG Letter, *supra* note 35, at 9-10.

access to clearing.⁴²⁴ This commenter identified three overarching principles or concerns with respect to FICC’s current clearing access models “that must be addressed in any final rule.” First, the commenter stated that FICC’s rules must ensure that an indirect participant can consolidate the clearing of its portfolio in one or a small number of direct participants by requiring a direct participant offering customer clearing to accept transactions executed by the customer with third-party executing firms (that is, to accept “done-away” transactions). The commenter stated that under the current FICC rules, indirect participants may be prevented by their clearing firms from clearing these “done-away” transactions, which means that the indirect participant often needs to establish a clearing relationship with each executing counterparty, which divides portfolios, increases margin costs and operational complexity, and potentially reduces netting efficiencies.⁴²⁵ In response to this comment, for the reasons explained above, the Commission is not prescribing particular access models.

Second, the commenter stated that indirect participants should be able to access central clearing models providing for FICC to guarantee settlement of their transactions, which the commenter asserts is not the case with certain models today including FICC’s correspondent and prime broker models. The commenter states that these models do not afford indirect participants the benefits of central clearing because settlement of the transactions they clear through those models remains dependent upon the direct participant because the indirect participant does not face FICC directly. The commenter states that because a clearing mandate would, in practice, force many market participants to contract with FICC direct participants to access clearing (and would disallow various bilateral settlement models), it is critical that the Commission ensure that

⁴²⁴ MFA Letter, *supra* note 81, at 5; MFA Letter II, *supra* note 125, at 3-4.

⁴²⁵ MFA Letter, *supra* note 81, at 7; MFA Letter II, *supra* note 125, at 3-4.

settlement of such market participants' transactions is not contingent upon circumstances outside the indirect participants' control, including, for example, the solvency of a direct participant.⁴²⁶

The Commission recognizes that certain access models offered by FICC may not result in a contractual relationship or direct obligation between FICC and the indirect participant, meaning that FICC itself cannot guarantee settlement of such transactions. The Commission observes that this generally would be the case in any agent clearing relationship in which an indirect participant relies upon a direct participant to submit transactions for clearing on its behalf. For example, customers who access DCOs through an FCM that is a direct participant in the DCO may face exposure if the FCM fails. DCO rules generally require that it take steps to port the customer transactions (*i.e.*, to transfer the customer positions to a new direct participant if the customer's original direct participant defaults), but ultimately retain the ability to close out the transactions if needed, leaving the customer to seek redress from its direct participant.⁴²⁷ However, this structure still provides the benefits of central clearing to the market as a whole, as described in part II.A.1 *supra*, despite the fact that an indirect participant may face continued exposure to its agent direct participant.

Third, the commenter states that an indirect participant should have the ability (although not the obligation) to fund the margin obligations of the direct participant clearing on its behalf which are attributable to the indirect participant. The commenter states that given that many indirect participants have fiduciary obligations to their own clients, it is crucial that indirect participants are able to post margin on a segregated basis such that their clients are not subject to

⁴²⁶ MFA Letter, *supra* note 81, at 7; *see also* MFA Letter II, *supra* note 125, at 4.

⁴²⁷ *See, e.g.*, ICE Clear Credit Rule 20A-02(a) (describing what happens in the event that FICC determines to effect the closing-out Process for client-related positions of a defaulting participant); CME Group Exchange Rule 802.G(1) (describing the DCO's ability to terminate transactions in a customer futures account).

the credit risk of others (and, likewise, that their funds are not subject to loss mutualization), which would promote systemic risk mitigation by facilitating a defaulter-pays model for clearing by indirect participants.⁴²⁸ The Commission addressed this issue in its discussion of a similar comment in part II.A.2.a.ii *supra*.

One commenter stated that the Commission should undertake a study of possible models to access U.S. Treasury securities CCAs, including models used in other markets. The commenter stated that current access models may not be suited for all participants or commercial arrangements, for various reasons including FICC membership requirements, operational constraints, and resource costs associated with legal documentation. The commenter stated that implementing a central clearing requirement without a comprehensive analysis regarding the suitability of current models to access U.S. Treasury securities CCAs and whether there is a need for additional models or revisions to current models could drive market participants away from transacting with direct participants or from the Treasury market entirely, if such participants do not believe there is a reasonable means of accessing a CCA. The commenter stated that such study should take place prior to the adoption of any rule requiring additional central clearing.⁴²⁹ Another commenter suggested that the Commission conduct a holistic review of FICC rules to ensure fair access for all market participants (both direct participants and indirect participants), prior to imposing any requirements.⁴³⁰

The Commission does not agree that a formal study or holistic review of access models must occur before adoption of the proposal. As discussed in part II.C.2 *supra*, a U.S. Treasury securities CCA generally should consider these topics, such as the sustainability of current models

⁴²⁸ MFA Letter, *supra* note 81, at 7.

⁴²⁹ SIFMA/IIB Letter, *supra* note 37, at 24.

⁴³⁰ MFA Letter II, *supra* note 125, at 5.

and the need for additional models or revisions, as well as the potential applicability of models used in other markets, as part of the CCA's consideration of its compliance with this proposed rule. The Commission will have the opportunity to consider these issues as well, in its review of any changes to access models filed pursuant to Section 19(b) of the Exchange Act.

Finally, one commenter stated that the Commission's goal of ensuring access for indirect participants to U.S. Treasury securities CCAs should be balanced against sufficiently robust membership criteria to ensure risk is appropriately managed.⁴³¹ The commenter cautioned that any expansion of access to U.S. Treasury securities CCA services should not relax membership requirements essential for appropriate risk management.⁴³² The commenter stated that less stringent membership requirements in the name of increasing access to central clearing would increase the risk of a participant default, increasing risk to FICC.⁴³³ The Commission agrees with the commenter that membership requirements are essential to a covered clearing agency's risk management. As the Commission stated in the Proposing Release, membership requirements help to guard against defaults of any CCP member, as well as to protect the CCP and the financial system as a whole from the risk that one member's default could cause others.⁴³⁴ Membership requirements will remain essential even with the requirement to clear eligible secondary market transactions, and U.S. Treasury securities CCAs generally should not relax membership requirements to accommodate such a requirement. A U.S. Treasury securities CCA is subject to Rule 17ad-22(e)(18)(i), (ii), and (iii), which requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based,

⁴³¹ SIFMA/IIB Letter, *supra* note 37, at 23.

⁴³² SIFMA/IIB Letter, *supra* note 37, at 24.

⁴³³ *Id.* at 25.

⁴³⁴ Proposing Release, *supra* note 14, 87 FR at 64623.

and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis. These requirements should help ensure that CCAs are not able to use less stringent membership requirements to comply with the requirement to clear eligible secondary market transactions. Moreover, any changes to FICC's membership requirements would necessarily encompass a change to FICC's Rules, which would be subject to Commission review and consideration pursuant to Section 19(b) of the Exchange Act.

One commenter stated that the Commission must address other aspects of the Sponsored Service to better promote the objectives of central clearing, with such issues including the treatment of the start leg of the transaction, FICC's obligations to complete settlement of a Sponsored Member's positions in the event of a Sponsoring Member's default, and a Sponsored Member's ability to engage with FICC to address issues arising from repo transactions that have been submitted through sponsored clearing.⁴³⁵

With respect to the start leg of the transaction, the commenter stated that, within the Sponsored Service, FICC does not novate the settlement of the start leg of a repo transaction that is submitted for clearing between a Sponsoring Member and a Sponsored Member, although it does novate the end leg of the transaction, meaning that the counterparties continue to be responsible for settlement outside of FICC and bear the risk of a settlement fail vis à vis one another. The commenter also states that the lack of central clearing for the start leg of repo transactions in the Sponsored Service means that a requirement to clear eligible secondary market transactions may

⁴³⁵ ICI Letter, *supra* note 85, at 26-28.

not eliminate counterparty credit risk issues to the extent the Commission anticipates, which, in turn, means that the proposal may not increase competition or reduce spreads as the Commission predicted in the Proposing Release.

A U.S. Treasury repo transaction generally encompasses both the start leg and the end leg of a U.S. Treasury repo. The Commission understands that, currently, the only U.S. Treasury securities CCA novates the start legs of many types of repo transactions cleared by the CCA, but does not provide central clearing for the start legs of repo transactions cleared through a particular client clearing access model.

The Commission understands that, contrary to transactions cleared at FICC outside the Sponsored Service, FICC currently does not novate the start legs of same-day settling Sponsored DVP Repos where the Sponsored Member's pre-novation counterparty is its Sponsoring Member (*i.e.*, "done-with" Sponsored DVP Repo) or of Repos. The Commission acknowledges that this transaction occurring outside central clearing could somewhat reduce the benefits of central clearing in this limited instance, but the counterparty credit risk arising from the start legs of such transactions are largely addressed by the fact that they usually settle on a delivery-versus-payment basis between the counterparties, meaning that the securities and funds are exchanged simultaneously and resulting in less counterparty credit risk to address. The Commission does not believe that the lack of clearing for the start leg undermines the overall benefits of the requirement to clear eligible secondary market transactions. However, the Commission further understands that FICC has stated that it is able to clear the start leg of any repo transaction and currently does clear the start leg of all repos between two direct participants, the start leg of any Sponsored DVP repo where the Sponsored Member's pre-novation counterparty is a third-party member of FICC (*i.e.*, "done-away" from the Sponsoring Member), and any Sponsored DVP Repo where the start

leg of such repo is scheduled to settle on some business day in the future (*i.e.*, forward-settling repos).⁴³⁶ The Commission would consider any proposal to provide additional clearing of repo start legs in particular access models in due course, consistent with its obligations under Section 19(b) of the Exchange Act.

With respect to the completion of settlement of a Sponsored Member's transactions if the Sponsoring Member defaults, the commenter states that neither the Sponsored Bilateral DVP Service nor the Sponsored GC Repo Service compel FICC to complete the settlement of a sponsored member's transactions in the event of a sponsoring member's default, and that this approach is not consistent with the Commission's assumption that central clearing increases the likelihood of settlement.⁴³⁷ The Commission agrees that in most cases of a Sponsoring Member's default, the ability for the CCA to settle its sponsored transactions likely would tend to minimize market disruption. However, the Commission understands that the current structure of the Sponsored Service, as set forth in FICC's rules, would allow FICC the ability to, potentially, terminate the Sponsored Member's transaction in such circumstances, and that this structure arises from the fact that, by design, the Sponsoring Member serves as the processing agent for all movement of funds and securities for its Sponsored Members. FICC is not able to guarantee that an insolvent Sponsoring Member, which may be subject to the control of another legal entity, such as a bankruptcy trustee, would be able to continue processing such transactions, thereby allowing settlement to occur. This aspect of FICC's rules is consistent with how other central counterparties have addressed the potential termination of customer transactions in the event of their agent's default.⁴³⁸ The Commission does not believe that the potential for FICC to terminate these

⁴³⁶ See FICC Rule 11, section 2, *supra* note 19; FICC Buyside FAQ, *supra* note 169, at 2-3.

⁴³⁷ ICI Letter, *supra* note 85, at 27.

⁴³⁸ See note 427 *supra*.

transactions, in the unlikely event of a Sponsoring Member default in which it is unable to work with the controlling legal entity, means that the benefits in the Proposing Release would not be, to a great extent, realized. Based on its supervisory knowledge, the Commission is not aware of any instance in which FICC was unable to work with the controlling legal entity for a defaulting member (*i.e.*, a member for which FICC has ceased to act). Therefore, this is an extremely infrequent event and would depend on the facts and circumstances of a particular insolvency.

With respect to the overall structure of the Sponsored Service, one commenter stated that market participants have raised concerns about the ability, as sponsored members, to engage with FICC to address issues arising from repo transactions that have been submitted through sponsored clearing, which, if not addressed, may prove to be a further impediment to the expansion of sponsored repo clearing. The commenter also states that market participants have cited challenges with seeking recourse from FICC in cases where the sponsoring member is in default.⁴³⁹ As discussed in the prior paragraph, the Commission understands that this is inherent to the design of the Sponsored Service, in that the Sponsoring Member serves as a processing agent for all the Sponsored Member's cleared transactions. FICC's rules address how it would proceed in the event of a Sponsoring Member default, including in the event that it closes out a Sponsored Member's transactions.⁴⁴⁰ In the event that FICC chooses to revisit this structure to provide some additional ability for the Sponsored Member to directly access FICC, without relying on its Sponsoring Member, the Commission would consider such a proposal in due course, consistent with its obligations under Section 19(b) of the Exchange Act.

⁴³⁹ ICI Letter, *supra* note 85, at 27-28.

⁴⁴⁰ See FICC Rule 3A, section 14(c) (stating that FICC would rely upon Rule 22, section 3 to close out Sponsored Member transactions and to determine the amount owed to or due from a Sponsoring Member), *supra* note 19.

d. Final Rule

For the reasons discussed in parts II.B.2.a through c, the Commission is adopting Rule 17ad-22(e)(18)(iv)(C) as proposed. To facilitate compliance with this requirement, a U.S. Treasury securities CCA generally should conduct and document an initial review of its access models and related policies and procedures. As it conducts this review, in view of the critical services it provides, the U.S. Treasury securities CCA generally should seek to provide access in as flexible a means as possible, consistent with its responsibility to provide sound risk management and comply with other provisions of the Exchange Act, the Covered Clearing Agency Standards, and other applicable regulatory requirements. A U.S. Treasury securities CCA generally should consider a wide variety of 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. To ensure that it considers a sufficiently broad set of perspectives, the U.S. Treasury securities CCA generally should consult with a wide-range of stakeholders, including indirect participants, as it seeks to comply with proposed rule 17ad-22(e)(18)(iv)(C).

A U.S. Treasury securities CCA generally should review and document any instance in which its policies and procedures treat transactions differently based on the identity of the participant submitting the transaction, the fact that an indirect participant is a party to the transaction, or the method of execution, or in any other way, and confirm that any variation in the treatment of such transactions is necessary and appropriate to meet the minimum standards regarding, among other things, operations, governance, and risk management identified in the Covered Clearing Agency Standards. The review by a U.S. Treasury securities CCA's board of directors under proposed Rule 17ad-22(e)(18)(iv)(C) generally should include consideration of whether to establish policies and procedures that enable direct members to submit to the U.S. Treasury securities CCA eligible transactions for clearance and settlement that have been executed

by two indirect participants of the U.S. Treasury securities CCA, which could potentially help address some of the concerns potential participants raised about the inability to present “done away” trades for clearance and settlement described above. Finally, as part of its consideration, a U.S. Treasury securities CCA generally should consider the volumes and proportion of the market that are being centrally cleared through different access models as part of the CCA’s consideration of whether its access models are meeting the needs of the market. To the extent that a U.S. Treasury securities CCA’s initial (or any subsequent) review occasions a change to its rules, such U.S. Treasury securities CCA would need to file such changes for Commission review and approval, as appropriate, under section 19(b) of the Exchange Act and Title VIII of the Dodd-Frank Act.⁴⁴¹ The review by a U.S. Treasury securities CCA’s board of directors under proposed Rule 17ad-22(e)(18)(iv)(C) generally should include consideration whether the U.S. Treasury securities CCA’s written policies and procedures are reasonably designed to ensure 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.

C. Amendments to Rule 15c3-3a

1. Introduction

The rules adopted above could cause a substantial increase in the margin broker-dealers must post to a U.S. Treasury securities CCA resulting from their customers’ cleared U.S. Treasury positions.⁴⁴² 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 U.S. Treasury securities CCA. This is because no U.S. Treasury securities CCA has implemented rules

⁴⁴¹ See 15 U.S.C. 78s(b); 17 CFR 240.19b-4; 12 U.S.C. 5465(e).

⁴⁴² See Proposing Release, *supra* note 14, 87 FR at 63637.

and practices designed to segregate the margin and limit it to being used solely to cover obligations of the broker-dealer's customers. Therefore, increases in the amount of margin required to be deposited at a U.S. Treasury securities CCA as a result of the adoption of the Membership Proposal would result in corresponding increases in the need to use broker-dealers' cash and securities to meet these new requirements.⁴⁴³

To facilitate implementation of the Membership Proposal, the Commission proposed to amend Rule 15c3-3a to permit margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula, subject to the conditions discussed below. 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 U.S. Treasury securities CCA. The debit item would be reported on a newly created Item 15 of the Rule 15c3-3a reserve formula. The proposed amendments also set forth a number of conditions that would need to be met to include the debit in the reserve formula. As discussed below, these proposed conditions were designed to permit the inclusion of the debit under conditions that would provide maximum protection to the broker-dealer's customers. The goal of the proposed amendments was to facilitate implementation of the Membership Proposal in a way that does not diminish the customer-protection objective of Rules 15c3-3 and 15c3-3a.⁴⁴⁴

The proposed conditions would be set forth in a new Note H to the reserve formula similar to how the conditions for including a debit in the reserve formula with respect to margin required and on deposit at a securities futures clearing agency or DCO are set forth in Note G. The proposed amendments were based, in part, on the conditions in Note G and the requirements in

⁴⁴³ Proposing Release, *supra* note 14, 87 FR at 64637.

⁴⁴⁴ Proposing Release, *supra* note 14, 87 FR at 64637.

Rules 15c3-3 and 15c3-3b for including a debit with respect to margin required and on deposit at security-based swap clearing agency. The Note G conditions and requirements of Rules 15c3-3 and 15c3-3b similarly were designed to permit the debit under circumstances that provide protection to customers.⁴⁴⁵

Overall, commenters supported the proposal to permit this debit item.⁴⁴⁶ Commenters stated that the proposed amendments would make clearing more efficient and free up resources that could be used to meet the CCA's margin requirements, while continuing to protect customer funds.⁴⁴⁷ Commenters also stated that the proposal would incentivize central clearing.⁴⁴⁸ A commenter stated that the proposal would extend to margin held at a U.S. Treasury securities CCA the same treatment as margin posted to other clearing organizations.⁴⁴⁹ As a result, this commenter stated that the proposal would facilitate greater access to clearing and eliminate an undue burden on competition. Another commenter—in supporting this aspect of the proposal—stated that it does not make sense that margin cannot be freely rehypothecated from a customer through a broker-dealer to a U.S. Treasury securities CCA without the broker-dealer receiving a beneficial adjustment as part of its customer reserve formula calculation.⁴⁵⁰ For greater and more efficient client clearing, another commenter encouraged the Commission to adopt this proposal irrespective of whether the Membership Proposal is adopted.⁴⁵¹

⁴⁴⁵ Proposing Release, *supra* note 14, 87 FR at 64637.

⁴⁴⁶ See AIMA Letter, *supra* note 81, at 8; CME Letter, *supra* note 81, at 4; DTCC/FICC Letter, *supra* note 33, at 28-29; ICE Letter, *supra* note 33, at 3; MFA Letter, *supra* note 81, at 10; ISDA Letter, *supra* note 391, at 2; SIFMA AMG Letter, *supra* note 35, at 8.

⁴⁴⁷ See AIMA Letter, *supra* note 81, at 8; MFA Letter, *supra* note 81, at 10; SIFMA/IIB Letter, *supra* note 37, at 27-28.

⁴⁴⁸ See CME Letter, *supra* note 81, at 4; SIFMA AMG Letter, *supra* note 35, at 8.

⁴⁴⁹ See DTCC/FICC Letter, *supra* note 33, at 28.

⁴⁵⁰ See SIFMA AMG Letter, *supra* note 35, at 8.

⁴⁵¹ See ISDA Letter, *supra* note 391, at 2.

Commenters did suggest certain modifications to the proposal. The Commission's responses to comments, modifications to the proposed rule text made in response to comments, and the final amendments are discussed below.

2. Credit Items

Cash delivered by a customer to the broker-dealer to be posted by the broker-dealer to a U.S. Treasury securities CCA would be a free credit balance or other credit balance in the customer's securities account. Thus, this cash will need to be included in Item 1 to the Rule 15c3-3a formula. Further, when a broker-dealer uses customer margin securities to borrow funds or execute a securities loan transaction, the firm must put a credit in the formula.⁴⁵² The credit items are designed to require the broker-dealer to reserve sufficient funds to be able to retrieve securities that collateralize the borrowed funds or have been loaned. There is not a specific Item in the Rule 15c3-3a formula to include the credit arising from the broker-dealer's use of customers' securities to meet a margin requirement imposed on the broker-dealer by a U.S. Treasury securities CCA. Consequently, the Commission proposed to amend Note B to Item 2 of the Rule 15c3-3a formula to instruct broker-dealers to include as a credit in Item 2 the market value of customers' U.S. Treasury securities on deposit at a U.S. Treasury securities CCA that meets the definition of a "qualified clearing agency" in Note H.⁴⁵³ The Commission did not receive any comments on this aspect of the proposal and is adopting it substantially as proposed.⁴⁵⁴

⁴⁵² See Items 2 and 3 to Rule 15c3-3a.

⁴⁵³ See Proposing Release, *supra* note 14, 87 FR at 64638, n. 232.

⁴⁵⁴ See Note B to Item 2 of Rule 15c3-3a, as adopted. The phrase "customers' U.S. Treasury securities" in the note—as proposed—has been replaced with the more generic phrase "customers' securities" in the note, as adopted. *Id.* This modification conforms the note to modifications discussed below that expand the type of customer collateral that can be posted to the U.S. Treasury securities CCA. As proposed, the broker-dealer was limited to posting customer cash or U.S. Treasury securities. See Proposing Release, *supra* note 14, 87 FR at 64638. This provision is being modified to include any securities accepted as margin by the U.S. Treasury securities CCA, subject to certain conditions. See Note H(a)(1) to Item 15, as adopted.

3. New Debit Item

On the debit side of the formula, the Commission proposed renumbering current Item 15 of the Rule 15c3-3a formula as Item 16.⁴⁵⁵ As proposed, new Item 15 would identify as a debit in the Rule 15c3-3a formula margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act resulting from the following types of transactions in U.S. Treasury securities in customer accounts that have been cleared, settled, and novated by the clearing agency: (1) purchases and sales of U.S. Treasury securities; and (2) U.S. Treasury securities repurchase and reverse repurchase agreements (together “customer position margin”).⁴⁵⁶ As proposed, this debit item was limited to customer position margin required and on deposit at a clearing agency that clears, settles, and novates transactions in U.S. Treasury securities. Except for the debits identified in current Items 13 and 14 of the Rule 15c3-3a formula, margin required and on deposit at other types of clearing agencies or for other types of securities transactions would not qualify as a debit item under the proposal. Further, this debit item would be limited to customer position margin required and on deposit at the U.S. Treasury securities CCA resulting from U.S. Treasury positions in customer accounts. Margin required and on deposit at the U.S. Treasury securities CCA as result of the broker-dealer’s proprietary U.S. Treasury positions could not be included in this debit item. This proposed limitation would effectuate a fundamental aspect of Rule 15c3-3: that customer cash and securities not be used by the broker-dealer to finance its proprietary business activities.

Finally, the debit would be limited to customer position margin *required* and on deposit at the U.S. Treasury securities CCA. This would mean that the broker-dealer could not include in

⁴⁵⁵ Current Item 15 is where the broker-dealer reflects the amount, if any, that total credits exceed total debits.

⁴⁵⁶ See Proposing Release, *supra* note 14, 87 FR at 64637.

this debit item amounts on deposit at the U.S. Treasury securities CCA that exceed the broker-dealer's margin requirement resulting from its customers' cleared U.S. Treasury securities positions. This limitation is designed to prevent the broker-dealer from artificially increasing the amount of the debit item by depositing cash and securities at the U.S. Treasury securities CCA that are not needed to meet a margin requirement resulting from its customers' U.S. Treasury securities positions. The Commission did not receive any comments on these aspects of the proposal and is adopting them as proposed.⁴⁵⁷

4. Note to New Debit Item

As proposed, Item 15 of the Rule 15c3-3a formula would have a Note H ("Note H") that sets forth conditions that would need to be met to include the amount of customer position margin required and on deposit at the U.S. Treasury securities CCA as a debit.⁴⁵⁸ Each of the conditions in Note H to Item 15 would need to be met for a broker-dealer to include a debit equal to the amount of customer position margin required and on deposit at the U.S. Treasury securities CCA. As discussed below, the Commission is adopting the conditions largely as proposed, with some modifications in response to comments.⁴⁵⁹

a. First Condition – Permitted Collateral

The first condition—set forth in paragraph (a) of Note H—provided that the debit item could be included in the Rule 15c3-3a formula to the extent that the customer position margin is in the form of cash or U.S. Treasury securities and is being used to margin U.S. Treasury securities positions of the customers of the broker-dealer that are cleared, settled, and novated at the U.S.

⁴⁵⁷ See Item 15 of the Rule 15c3-3a formula, as adopted.

⁴⁵⁸ Proposing Release, *supra* note 14, 87 FR at 64638-40.

⁴⁵⁹ See Note H to Rule 15c3-3a, as adopted.

Treasury securities CCA.⁴⁶⁰ The objective was to limit the assets underlying the debit item to the safest and most liquid instruments, given that the debit item would offset credit items (cash owed to customers).⁴⁶¹ As discussed above, the liquidity of the debit items protects the customers whose cash or securities are used to finance or facilitate customer transactions.

In response to the proposed first condition, commenters stated that the Commission should expand the types of securities that could be used to meet the customer position margin requirement.⁴⁶² Specifically, one commenter stated that the use of the debit should not be limited to margin in the form of cash or Treasury securities.⁴⁶³ This commenter stated that FICC accepts additional securities for clearing fund deposits, including eligible obligations of U.S. agencies or government sponsored entities and eligible mortgage-backed securities.⁴⁶⁴ The commenter also stated that the Commission found—in the context of approving a FICC rule change—that the expanded scope of acceptable forms of clearing fund collateral deposits would “better enable FICC to assure the safeguarding of securities and funds in its custody or control or for which it is responsible,” and therefore was consistent with the requirements of the Exchange Act and other governing regulations.⁴⁶⁵

In response to comments, the Commission is modifying paragraph (a) of Note H to permit

⁴⁶⁰ Proposing Release, *supra* note 14, 87 FR at 64638.

⁴⁶¹ See, e.g., 17 CFR 240.15c3-3(e) (limiting the assets that can be deposited into the customer reserve account to cash and qualified securities); 17 CFR 240.15c3-3(a)(6) (defining the term “qualified security” to mean a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States).

⁴⁶² See ISDA Letter, *supra* note 391; SIFMA/IIB Letter, *supra* note 37, at 29.

⁴⁶³ See SIFMA/IIB Letter, *supra* note 37, at 29.

⁴⁶⁴ See SIFMA/IIB Letter, *supra* note 37, at 29.

⁴⁶⁵ See SIFMA/IIB Letter, *supra* note 37, at 29 (citing Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Modify its Rules to Diversify and Standardize Clearing Fund Collateral Requirements Across the Divisions to Improve Liquidity and Minimize Risk for its Members, Exchange Act Release No. 54969 (Dec. 26, 2006), 71 FR 77837, 77838 (Dec. 27, 2006)).

“qualified customer securities” to be used to meet the customer position margin requirement in addition to cash and U.S. Treasury securities.⁴⁶⁶ The term “qualified customer securities” is defined to mean securities of a customer of the broker-dealer (other than U.S. Treasury securities) that are held in custody by the broker-dealer for the customer and that under the rules of the U.S. Treasury securities CCA are eligible to be used to margin U.S. Treasury securities positions of the customer that are cleared, settled, and novated by the CCA.⁴⁶⁷ Therefore, a broker-dealer may post cash, U.S. Treasury securities, and qualified customer securities (*i.e.*, securities other than U.S. Treasury securities that are accepted by the U.S. Treasury securities CCA) to meet a customer position margin requirement.

As proposed, paragraph (b) of Note H set forth the second, third, and fourth conditions that would need to be met to include the amount of customer position margin required and on deposit at the U.S. Treasury securities CCA as a debit item.⁴⁶⁸

b. Second Condition – Customer Position Margin

The second condition—set forth in paragraph (b)(1) of Note H—provided that the customer position margin must consist of cash owed to the customer of the broker-dealer or U.S. Treasury securities held in custody by the broker-dealer for the customer that was delivered by the broker-dealer to meet to meet a margin requirement resulting from that customer’s U.S. Treasury securities positions cleared, settled, and novated at the U.S. Treasury securities CCA and not for

⁴⁶⁶ See Rule 15c3-3a, Note H(a)(1), as adopted. To implement this modification, paragraph (a) of Note H is being divided into subparagraphs (a)(1) and (2). Subparagraph (a)(1) identifies the types of collateral that can be used to meet the customer position margin requirement (*i.e.*, cash, U.S. Treasury securities, and qualified customer securities), and subparagraph (a)(2) contains the text that provides that the collateral must be used to margin U.S. Treasury securities positions of the customers of the broker-dealer that are cleared, settled, and novated by the qualified clearing agency, as was proposed. See Rule 15c3-3a, Note H(a)(1) and (2), as adopted.

⁴⁶⁷ See Rule 15c3-3a, Note H(c), as adopted.

⁴⁶⁸ See Note H(b)(1) through (3) of Rule 15c3-3a, as proposed.

any other customer's or the broker-dealer's U.S. Treasury securities positions cleared, settled, and novated at the U.S. Treasury securities CCA.⁴⁶⁹ In sum, to meet this condition, the broker-dealer would need to: (1) use customer assets exclusively to meet the customer position margin requirement; (2) use a particular customer's assets exclusively to meet the amount of the customer position margin requirement resulting from that customer's cleared U.S. Treasury securities positions; and (3) have delivered the customer's assets to the U.S. Treasury securities CCA.

The objective of the first component of the second condition—the need to use customer assets exclusively—was to segregate the customer assets being used to meet the customer position margin requirement from the broker-dealer's proprietary assets.⁴⁷⁰ Additional conditions—under the proposal—provided that the U.S. Treasury securities CCA must hold the assets being used to meet the customer position margin requirement in an account of the broker-dealer that is segregated from any other account of the broker-dealer and is identified as being held for the exclusive benefit of the broker-dealer's customers.⁴⁷¹ The first prong of the condition was designed to ensure that only customer assets are held in the account.

The objective of the second component of the second condition—the need to use a particular customer's assets exclusively to meet the amount of the customer position margin requirement resulting from that customer's cleared U.S. Treasury securities positions—was to avoid the use of one customer's assets to meet another customer's margin requirement.⁴⁷² For example, FICC's Sponsored Member program allows its members to sponsor a person's (*i.e.*, a Sponsored Member's) U.S. Treasury securities transactions for clearance and settlement. FICC

⁴⁶⁹ Proposing Release, *supra* note 14, 87 FR at 64638.

⁴⁷⁰ Proposing Release, *supra* note 14, 87 FR at 64638.

⁴⁷¹ See Proposing Release, *supra* note 14, 87 FR at 64639-40 (discussing these additional conditions). As discussed below, the Commission is adopting these additional conditions, substantially as proposed.

⁴⁷² Proposing Release, *supra* note 14, 87 FR at 64638.

interacts solely with the sponsoring member as processing agent for purposes of the day-to-day satisfaction of the Sponsored Member's obligation to or from FICC, including the Sponsored Member's cash and securities settlement obligations. However, FICC calculates a separate margin requirement for each Sponsored Member's trading activity and the sum of each sponsored member's margin calculation is the aggregate margin requirement that must be met by the sponsoring member. Further, this margin is held in an omnibus account that is separate from the account that holds the Sponsoring Member's net margin obligation for non-sponsored securities transactions. In this scenario, the U.S. Treasury securities CCA's margin calculations and resulting requirements can be traced to a specific customer's cleared U.S. Treasury securities positions. Consequently, the broker-dealer would be able to allocate the amount of the U.S. Treasury securities CCA's daily customer position margin requirement attributable to a specific customer. Under this component of the second condition, the broker-dealer would need to deliver cash or U.S. Treasury securities belonging to that specific customer to meet the amount of the U.S. Treasury securities CCA's customer position margin requirement resulting from that customer's cleared U.S. Treasury securities positions. This would mitigate the risk to all the broker-dealer's customers by limiting when their assets can be used to meet the U.S. Treasury securities CCA's customer position margin requirement.

The objective of the third component of the second condition—that the broker-dealer had delivered the customer's assets to the U.S. Treasury securities CCA—was to address the potential that a customer may use more than one broker-dealer to engage in U.S. Treasury securities transactions.⁴⁷³ In this case, two or more broker-dealers may be subject to customer position margin requirements of the U.S. Treasury securities CCA resulting from the customer's cleared

⁴⁷³ Proposing Release, *supra* note 14, 87 FR at 64638-39.

U.S. Treasury securities positions. The intent was to prevent a broker-dealer from including as a debit the amount of customer position margin that another broker-dealer delivered to the U.S. Treasury securities CCA with respect to U.S. Treasury securities positions of a customer of both the broker-dealers. The amount that a given broker-dealer's debit items can offset its credit items should be limited to the amount of customer position margin it delivered to the U.S. Treasury securities CCA. Otherwise, the customers of the broker-dealer would be put at risk for transactions effected by another broker-dealer.

Two commenters stated that broker-dealers should not be limited to posting the same assets received from its customer to a U.S. Treasury securities CCA.⁴⁷⁴ One stated that in many instances, broker-dealers post proprietary assets to a clearing agency on behalf of a customer given timing and operational constraints.⁴⁷⁵ The other commenter stated that FICC collects clearing fund margin on a faster timeline than broker-dealers are able to collect margin from their customers.⁴⁷⁶ More specifically, this commenter stated that FICC collects margin from direct participants on an overnight and intraday basis, while most broker-dealers generally provide their customers with a full business day to post margin. As a result, this commenter stated that most broker-dealers generally post clearing fund margin to FICC and then subsequently collect that clearing fund margin from their customers. One of these commenters stated that posting proprietary collateral is permissible in the context of margin posted to the other clearing agencies and should also be permissible with respect to margin posted to a U.S. Treasury Securities CCA.⁴⁷⁷ Finally, one of these commenters stated that not allowing the use of proprietary assets would significantly

⁴⁷⁴ See DTCC/FICC Letter, *supra* note 33, at 32; SIFMA/IIB Letter, *supra* note 37, at 30.

⁴⁷⁵ See SIFMA/IIB Letter, *supra* note 37, at 30.

⁴⁷⁶ See DTCC/FICC Letter, *supra* note 33, at 32.

⁴⁷⁷ See SIFMA/IIB Letter, *supra* note 37, at 30.

undercut the benefits to the Rule 15c3-3a proposal.⁴⁷⁸

In response to comments, the Commission is modifying Note H under the final rule to permit broker-dealers to elect to deliver proprietary U.S. Treasury securities to meet a margin requirement of a customer resulting from that customer's U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency.⁴⁷⁹ This will address the concern raised by commenters that the U.S. Treasury securities CCA may call for margin from a broker-dealer arising from a customer's cleared U.S. Treasury security transaction before the customer is able to deliver the requisite margin to the broker-dealer. However, the final rule places strict limits on this requirement. First, the broker-dealer must use proprietary U.S. Treasury securities for this purpose and, therefore, it cannot use other types of securities collateral acceptable to the U.S. Treasury securities CCA.⁴⁸⁰ For example, as discussed above, a broker-dealer can post qualified customer securities (which are securities other than U.S. Treasury securities acceptable to the U.S. Treasury securities CCA), provided the customer has delivered them to the broker-dealer. However, the broker-dealer could not post these types of securities if they belong to the broker-dealer. This is designed to ensure that the safest most liquid securities of the broker-dealer are

⁴⁷⁸ See DTCC/FICC Letter, *supra* note 33, at 32.

⁴⁷⁹ See Note H(b)(1)(iii) of Rule 15c3-3a, as adopted. To implement this modification, paragraph (b)(1) is being divided into subparagraphs (b)(1)(i) through (iii). Subparagraphs (b)(1)(i) and (ii) contain the proposed components of the second condition that the broker-dealer can use cash owed to a customer or U.S. Treasury securities held in custody by the broker-dealer for the customer to meet a margin requirement of the U.S. Treasury securities CCA resulting from that customer's U.S. Treasury securities transactions cleared at the CCA, with the modifications that cash and securities are now addressed in a separate subparagraphs (subparagraphs (b)(1)(i) and (ii), respectively) and qualified customer securities held in custody by the broker-dealer for the customer also can be used for this purpose. See Note H(b)(1)(i) and (ii) of Rule 15c3-3a, as adopted. Subparagraph (b)(1)(iii) contains the new provision—discussed below—permitting the use of the broker-dealer's proprietary securities, subject to certain conditions. See Note H(b)(1)(iii) of Rule 15c3-3a, as adopted.

⁴⁸⁰ See prefatory text of Note H(b)(1)(iii) of Rule 15c3-3a, as adopted.

commingled with the customer cash and securities in the account.⁴⁸¹ It also will prevent the broker-dealer from using customer cash deposited with the broker-dealer to purchase less liquid securities and post them to the U.S. Treasury securities CCA to meet a customer position margin requirement.

Second, the broker-dealer's ability to post proprietary U.S. Treasury securities is limited to circumstances where the broker-dealer did not owe the customer or hold in custody for the customer sufficient cash, U.S. Treasury securities, and/or qualified customer securities to meet a margin requirement resulting from that customer's U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency at the time the margin requirement arose.⁴⁸² Thus, the broker-dealer is limited to using proprietary U.S. Treasury securities to address the specific concern raised by commenters: a timing mismatch between when margin must be delivered to the U.S. Treasury securities CCA and when the broker-dealer receives the margin from the customer.

Third, the broker-dealer must call for the customer to deliver a sufficient amount of cash, U.S. Treasury securities, and/or qualified customer securities to meet the margin requirement on the day the margin requirement arose and must receive a sufficient amount of cash, U.S. Treasury securities, and/or qualified customer securities to meet the margin requirement by the close of the next business day after the margin requirement arose.⁴⁸³ Thus, the broker-dealer can deliver

⁴⁸¹ See *supra* note 461; see also Section I. Introduction (describing the critical and unique role that U.S. Treasury securities play a critical in the U.S. and global economy) and Section IV.B. Economic Analysis – Baseline (describing U.S. Treasury securities and repos, and clearance and settlement of these positions); see also 17 CFR 240.15c3-1(c)(2)(vi)(A)(I) (prescribing haircuts under the broker-dealer net capital rule for a security issued or guaranteed as to principal or interest by the United States or any agency thereof ranging from 0 to 6%).

⁴⁸² See Note H(b)(1)(iii)(A) of Rule 15c3-3a, as adopted.

⁴⁸³ See Note H(b)(1)(iii)(B) and (C) of Rule 15c3-3a, as adopted.

proprietary U.S. Treasury securities to meet a margin call related to its customers' transactions as an interim step before receiving the associated margin from its customer no later than the close of the next business day. The objective is to narrowly confine the ability to use proprietary U.S. Treasury securities and thereby promote the final rule's objective of using a specific customer's collateral to meet a customer position margin requirement generated by that customer's cleared U.S. Treasury securities transactions.

c. Third Condition – Rules of U.S. Treasury Securities CCA

The third condition for including customer position margin as a debit in the Rule 15c3-3a formula was set forth in proposed paragraph (b)(2) of Note H.⁴⁸⁴ Under this condition, the customer position margin needed to be treated in accordance with rules of the U.S. Treasury securities CCA designed to protect and segregate the customer position margin, and the U.S. Treasury securities CCA and broker-dealer would need to be in compliance with those rules (as applicable). As proposed, paragraph (b)(2) of Note H identified five sets of rules that would need to be implemented by the U.S. Treasury securities CCA.⁴⁸⁵

The first rule set—identified in paragraph (b)(2)(i) of Note H—provided that the customer position margin must be treated in accordance with rules requiring the qualified U.S. Treasury securities CCA to calculate a separate margin amount for each customer of the broker-dealer and the broker-dealer to deliver that amount of margin for each customer on a gross basis.⁴⁸⁶ As discussed above, a component of the second condition—set forth in paragraph (b)(1) of Note H, as proposed—was that the broker-dealer use a particular customer's assets exclusively to meet the amount of the customer position margin requirement resulting from that customer's cleared U.S.

⁴⁸⁴ Proposing Release, *supra* note 14, 87 FR at 64639.

⁴⁸⁵ Proposing Release, *supra* note 14, 87 FR at 64639-40.

⁴⁸⁶ Proposing Release, *supra* note 14, 87 FR at 64639.

Treasury securities positions.⁴⁸⁷ The proposal that the U.S. Treasury securities CCA implement these margin calculation rules was designed to facilitate that condition. This would allow the broker-dealer to allocate the amount of the customer position margin requirement attributable to each of its customers. In addition, the rules needed to require the broker-dealer to deliver the margin amount calculated for each customer on a gross basis. This would mean that the risk of one customer's positions could not be offset by the risk of another customer's positions in determining the amount of customer position margin the broker-dealer would need to have on deposit at the U.S. Treasury securities CCA. As a result, the broker-dealer would not be able to deliver assets belonging to one customer to meet the margin requirement of another customer.

In response to this aspect of the proposal, a commenter suggested that the Commission modify the requirement to be consistent with the requirements of Item 13 and Note F to the reserve formula which covers margin required and on deposit with the Options Clearing Corporation ("OCC") for all option contracts written or purchased in customer accounts.⁴⁸⁸ In particular, the permitted debit under Item 13 and Note F is based on a margin amount posted to OCC that is calculated on a net basis across all the broker-dealer's customers with listed options positions. This is different than the proposal to permit a debit with respect to margin posted to a U.S. Treasury securities CCA in that the margin amount needed to be calculated for each customer on a gross basis and that gross amount to be delivered to the CCA. For the reasons discussed below, the Commission is retaining the requirement that the U.S. Treasury securities CCA implement rules requiring that the margin be calculated and delivered on a gross basis for each customer.⁴⁸⁹

Listed options cleared at the OCC are subject to customer margin requirements of the

⁴⁸⁷ Proposing Release, *supra* note 14, 87 FR at 64638-39.

⁴⁸⁸ See DTCC/FICC Letter, *supra* note 33, at 31.

⁴⁸⁹ See Note H(b)(2)(i) of Rule 15c3-3a, as adopted.

broker-dealer SROs.⁴⁹⁰ Under Rule 15c3-3, a broker-dealer can use customer cash or securities that are serving as margin for listed options positions under SRO margin rules, subject to certain limitations.⁴⁹¹ If the margin is in the form of cash, the broker-dealer needs to treat it as an “other credit balance” in the customer’s securities account and include it in Item 1 in the Rule 15c3-3a reserve formula.⁴⁹² The broker-dealer can use this cash to finance a margin loan to another customer, to borrow securities to effect a short sale of another customer, or to deliver it to the OCC to meet a margin requirement for other customers’ listed options positions cleared at the OCC.⁴⁹³ In each case, the “other credit balance” on the credit side of the Rule 15c3-3a reserve formula is offset by a corresponding debit balance on the debit side of the formula. If the margin is in the form of securities, the broker-dealer can rehypothecate them to obtain a bank loan, to deliver on a securities loan, or to meet a margin requirement of the OCC.⁴⁹⁴ The broker-dealer’s use of the customer’s margin securities generates a credit in the Rule 15c3-3a reserve formula that generally is offset by debits in the formula stemming from the broker-dealer’s financing of the customer’s

⁴⁹⁰ See, e.g., FINRA Rule 4210(f)(2); Cboe Rules 10.1 *et seq.*; see also 12 CFR 220.12(f). Generally, buyers of options (*i.e.*, long options) that expire in nine months or less must pay for these positions in full. Margin requirements for option writers (*i.e.*, short options) are complex and are not the same for every type of underlying security or component value. SRO rules generally require an option writer to post 100% of the options proceeds to the margin account, plus a specific percentage of the market value of the underlying securities or component value as options margin (*e.g.*, 20% for an option on a single equity security). SRO rules also recognize certain spread positions. Finally, equity-based options also are eligible positions under SRO securities portfolio margin rules. See, e.g., FINRA Rule 4210(f)(2) and (g); Cboe Rules 10.3 and 10.4.

⁴⁹¹ See 17 CFR 240.15c3-3.

⁴⁹² See 17 CFR 240.15c3-3a, Item 1.

⁴⁹³ See 17 CFR 240.15c3-3(e)(2) (providing, in pertinent part, that a broker-dealer must not accept or use any of the amounts under items comprising Total Credits under the Rule 15c3-3a reserve formula except for the specified purposes indicated under items comprising Total Debits under the formula); 17 CFR 240.15c3-3a, Items 10, 11, and 13.

⁴⁹⁴ See 17 CFR 240.15c3-3(a)(3), (4), and (5) (defining, respectively, the terms “fully paid securities,” “margin securities,” and “excess margin securities”); 17 CFR 240.15c3-3(b)(1) (providing, in pertinent part, that a broker-dealer shall promptly obtain and shall thereafter maintain the physical possession or control of all fully-paid securities and excess margin securities carried by a broker-dealer for the account of customers but not applying this requirement to margin securities).

margin loan, facilitating the customer's short sale, or delivering margin to the OCC to meet margin requirements arising from customer options positions.⁴⁹⁵

SRO options margin requirements help to protect the broker-dealer from the consequences of a customer default, because the required equity in a customer's account (because of the SRO option margin requirements) serves to over-collateralize an option customer's obligations to the broker-dealer. This buffer also protects the customers whose cash was used to facilitate the broker-dealer's financing of securities transactions of other customers (*i.e.*, margin loans, short sales, or to meet a margin requirement for other customers' listed options positions cleared at the OCC). For example, if the broker-dealer fails, the customer debits, because they generally are over-collateralized, should be attractive assets for another broker-dealer to purchase or, if not purchased by another broker-dealer, they should be able to be liquidated to a net positive equity.⁴⁹⁶ The proceeds of the debits sale or liquidation can be used to repay the customer cash used to finance the customer obligations. This cash plus the funds and/or U.S. government securities held in the customer reserve account should equal or exceed the total amount of customer credit items (*i.e.*, the total amount owed by the broker-dealer to its customers).⁴⁹⁷

In contrast, although SRO margin rules require the collection of margin for certain

⁴⁹⁵ See 17 CFR 240.15c3-3a, Items 2 and 3 (requiring, respectively, credits to be added to the Rule 15c3-3a reserve formula for: (1) monies borrowed collateralized by securities carried for the accounts of customers; and (2) monies payable against customers' securities loaned); 17 CFR 240.15c3-3a, Items 10, 11, and 13 (requiring, respectively, debits to be added to the reserve formula for: (1) debit balances in customers' cash and margin accounts; (2) securities borrowed to effectuate short sales by customers; and (3) margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer account).

⁴⁹⁶ The attractiveness of the over-collateralized debits facilitates the bulk transfer of customer accounts from a failing or failed broker-dealer to another broker-dealer.

⁴⁹⁷ See *Net Capital Requirements for Broker-Dealers; Amended Rules*, Exchange Act Release No. 18417 (Jan. 13, 1982), 47 FR 3512, 3513 (Jan. 25, 1982) ("The alternative approach is founded on the concept that, if the debit items in the Reserve Formula can be liquidated at or near their contract value, these assets along with any cash required to be on deposit under the [customer protection] rule, will be sufficient to satisfy all liabilities to customers (which are represented as credit items in the Reserve Formula).").

transactions in U.S. Treasury securities, transactions between dealers and institutional customers generally are subject to a variable “good-faith” margin standard, which the Commission understands—based on its supervisory experience—can often result in a broker-dealer collecting less (or no) margin collateral from a customer with respect to transactions in U.S. Treasury securities.⁴⁹⁸ Consequently, the SRO margin requirements for U.S. Treasury securities transactions do not result in the same levels of over-collateralization that the SRO margin requirements for listed options impose and, therefore, would not provide the same level protection to the broker-dealer’s customers. Accordingly, modifying the proposal to align it with how margin posted to the OCC is treated would diminish an important protection that the proposal is designed to achieve in terms of protecting the broker-dealer’s customers: preventing one customer’s cash or securities to be used to meet a margin requirement of the U.S. Treasury securities CCA resulting from another customer’s cleared U.S. Treasury securities transactions. This protection is achieved through the proposed requirements that the U.S. Treasury securities CCA calculate a gross margin amount for each of the broker-dealer’s customers and that the broker-dealer must meet that gross margin amount with cash or securities owned by the customer whose U.S. Treasury securities transactions generated the margin requirement.⁴⁹⁹

⁴⁹⁸ SRO rules provide for the collection of margin for cash U.S. Treasury transactions. *See, e.g.*, FINRA Rule 4210(e)(2)(A) (setting forth margin requirements for U.S. Treasury securities and certain other bonds). However, these rules do not necessarily apply to exempt accounts. *See* FINRA Rule 4210(e)(2)(F) (permitting FINRA-member broker-dealers to not collect margin for certain good faith securities held in exempt accounts and providing for a capital charge for any uncollected mark-to-market loss); FINRA Rule 4210(a)(13) (defining exempt account). Although SRO rules also require a broker-dealer to establish procedures to review limits and types of credit extended to all customers, formulate their own “house” margin requirements, and review the need for instituting higher margin requirements than are required for individual securities or customer accounts, based on the Commission’s supervisory experience, the resulting customer margin collection is often less than that required pursuant to FICC’s margin model. *See* Proposing Release, *supra* note 14, 87 FR at 64627 n.171.

⁴⁹⁹ As discussed above, under the final rule, the broker-dealer can use proprietary U.S. Treasury securities in limited circumstances and under strict conditions to meet a margin requirement of the U.S. Treasury securities CCA resulting from a particular customer’s cleared U.S. Treasury securities transactions. *See* Note H(b)(1)(iii) of Rule 15c3-3a.

Moreover, cash delivered by a customer to the broker-dealer to be posted by the broker-dealer to a U.S. Treasury securities CCA generally would be a free credit balance, given the minimal margin requirements of the SROs with respect to the types of U.S. Treasury securities transactions that would be cleared (*i.e.*, the cash would not have the same status as cash serving as margin for a listed options position under the SRO margin rules). For the same reason, securities delivered by a customer to the broker-dealer to be posted by the broker-dealer to a U.S. Treasury securities CCA generally would be fully paid securities (*i.e.*, they would not have the same status as margin securities serving as margin for listed options under the SRO margin rules). The proposal—consequently—set forth strict limitations on the broker-dealer’s ability to use the cash or securities to meet a margin requirement the U.S. Treasury securities CCA imposed on the broker-dealer. These limitations were designed to restrict the broker-dealer’s ability to use the customer cash and securities—and thereby protect them—given that these customer assets generally otherwise would need to be treated as a free credit balance or fully paid securities in the customer’s securities account.

For these reasons, the Commission is retaining the requirement that the U.S. Treasury securities CCA implement rules requiring that the margin be calculated and delivered on a gross basis for each customer.⁵⁰⁰ Therefore, the Commission is adopting the gross margining requirement, as proposed.

The second rule set—identified in paragraph (b)(2)(ii) of Note H—provided that the customer position margin be treated in accordance with rules requiring that the U.S. Treasury securities CCA be limited to investing it in U.S. Treasury securities with a maturity of one year or

⁵⁰⁰ See Note H(b)(2)(i) of Rule 15c3-3a, as adopted.

less.⁵⁰¹ The objective was to limit the assets underlying the debit item to the safest and most liquid instruments. The Commission did not receive comments on this aspect of the proposal and is adopting it as proposed.⁵⁰²

However, one commenter sought clarification that the conditions of Rule 15c3-3 would not preclude a U.S. Treasury securities CCA from entering into a repurchase transaction using customer cash margin, so long as the purchased securities under such repurchase transaction consist of U.S. Treasury securities held in a segregated account for the benefit of customers and satisfy certain other requirements.⁵⁰³ The commenter stated that the proposal was not clear whether the conditions related to Rule 15c3-3 would preclude a U.S. Treasury securities CCA from using customer margin for liquidity purposes, and that 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.⁵⁰⁴ The commenter further explained that if a U.S. Treasury securities CCA could not use customer margin as a qualifying liquid resource, for purposes of its obligations under Rule 17ad-22(e)(7), it might need to obtain liquidity resources from other sources, which could mean increasing certain requirements applicable to direct participants or increasing the cash margin requirements applicable to direct participants and/or other indirect participants.⁵⁰⁵ Finally, the

⁵⁰¹ See Proposing Release, *supra* note 14, 87 FR at 64639.

⁵⁰² See Note H(b)(2)(ii) of Rule 15c3-3a, as adopted.

⁵⁰³ Letter from Brian Steele, Managing Director, President of DTCC Clearing Agency Services, Head of Global Business Operations, and Laura Klimpel, General Manager of FICC, Head of SIFMU Business Development, at 1-2 (Nov. 10, 2023) (“DTCC/FICC Letter II”).

⁵⁰⁴ *Id.* at 2. The commenter stated that a U.S. Treasury securities CCA could enter into a repurchase transaction with a broker-dealer, as agent for its customers, pursuant to which the broker-dealer purchases U.S. Treasury securities using customer cash margin and holds such securities in a segregated account of the broker-dealer. *Id.*

⁵⁰⁵ *Id.* at 5.

commenter suggested adding language to Note H that a CCA's use of cash margin for liquidity purposes would not cause item 15 to cease to apply, so long as (i) the CCA only uses the cash margin after it determines that it does not have the ability to obtain liquidity from other resources in order to satisfy the cash payment obligations that were originally due to be paid by a defaulting member, (ii) in connection with such usage, the CCA deposits into and maintains an account of the broker-dealer that generally satisfies the requirements for a special reserve account U.S. Treasury securities or cash that at all relevant times have a value of no less than the value amount of used cash, and (iii) the CCA replenishes the cash margin promptly after the liquidity need is satisfied.⁵⁰⁶

The objective of the conditions for including the debit in the customer reserve formula is to provide maximum protection to the cash or securities delivered to the U.S. Treasury securities CCA. The commenter provides a summary of potential protections that could be put in place to ensure that—if a U.S. Treasury securities CCA uses cash in the broker-dealer's segregated account for liquidity purposes—the cash will be protected through collateral comprising U.S. Treasury securities deposited into the account and other measures. The Commission would need to review a more detailed plan for how the cash will be used and customers protected before taking any action on any formal request. In this regard, were FICC to file proposed rule changes that provide specific details regarding the protections and how cash will be used, the Commission will consider those proposed rule changes at that time consistent with the statutory standard for approval under Section 19(b).

The third rule set—identified in paragraph (b)(2)(iii) of Note H—provided that the customer position margin be treated in accordance with rules designed to address the segregation of the broker-dealer's account at the U.S. Treasury securities CCA that holds the customer position

⁵⁰⁶ *Id.* at 7-8.

margin and set strict limitations on the U.S. Treasury securities CCA's ability to use the margin.⁵⁰⁷

The required rules were modeled on the requirements for a broker-dealer to include a debit with respect to margin delivered to a security-based swap clearing agency.⁵⁰⁸ In particular, the note provided that the customer position margin needed to be treated in accordance with rules requiring that it must be held in an account of the broker-dealer at the U.S. Treasury securities CCA that is segregated from any other account of the broker-dealer at the U.S. Treasury securities CCA and that is:

- Used exclusively to clear, settle, novate, and margin U.S. Treasury securities transactions of the customers of the broker-dealer;
- Designated "Special Clearing Account for the Exclusive Benefit of the Customers of [name of broker-dealer]";
- Subject to a written notice of the U.S. Treasury securities CCA provided to and retained by the broker-dealer that the cash and U.S. Treasury securities in the account are being held by the U.S. Treasury securities CCA for the exclusive benefit of the customers of the broker-dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker-dealer or any other clearing member at the U.S. Treasury securities CCA; and
- Subject to a written contract between the broker-dealer and the U.S. Treasury securities CCA which provides that the cash and U.S. Treasury securities in the account are not available to cover claims arising from the broker-dealer or any other clearing member

⁵⁰⁷ Proposing Release, *supra* note 14, 87 FR at 64639.

⁵⁰⁸ See 17 CFR 240.15c3-3(p)(1)(iii) (defining the term "qualified clearing agency account"); 17 CFR 240.15c3-3b, Item 15 (permitting a broker-dealer to include a debit in the security-based swap reserve formula equal to the margin required and on deposit in a qualified clearing agency account at a clearing agency).

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

The objective was to protect the customer position margin that the broker-dealer deposits with the U.S. Treasury securities CCA to margin its customers' U.S. Treasury security positions by isolating it from any other assets of the broker-dealer at the U.S. Treasury securities CCA and to prevent it from being used to cover any obligation other than an obligation of the broker-dealer's customer resulting from a U.S. Treasury transaction cleared, settled, and novated in the account.⁵⁰⁹ Further, the account designation and written notice requirements were designed to alert creditors of the broker-dealer and U.S. Treasury securities CCA that the assets in this account are not available to satisfy any claims they may have against the broker-dealer or the U.S. Treasury securities CCA. The written contract requirement was designed to limit the U.S. Treasury securities CCA's rights to use the customer position margin for any purpose other than an obligation of the broker-dealer's customers. For example, the assets in the account could not be used to cover an obligation of the broker-dealer to the U.S. Treasury securities CCA if the broker-dealer defaults on the obligation. Similarly, the assets in the account could not be used to mutualize the loss across the U.S. Treasury securities CCA's members if a member defaulted and its clearing funds were insufficient to cover

⁵⁰⁹ Proposing Release, *supra* note 14, 87 FR at 64639.

the loss. The Commission did not receive comments on this aspect of the proposal and is adopting it substantially as proposed.⁵¹⁰

The fourth rule set—identified in paragraph (b)(2)(iv) of Note H—provided that the customer position margin be treated in accordance with rules designed to address how the U.S. Treasury securities CCA holds the customer position margin.⁵¹¹ The objective was to isolate the customer position margin and prevent it from being used to satisfy the claims any creditors may have against the U.S. Treasury securities CCA. In particular, the note provided that the customer position margin needed to be treated in accordance with rules of the U.S. Treasury securities CCA requiring that the U.S. Treasury securities CCA hold the customer position margin itself or at either a U.S. Federal Reserve Bank or a “bank” (as defined in section 3(a)(6) of the Exchange Act (15 U.S.C. 78c(a)(6)) that is insured by the Federal Deposit Insurance Corporation. The objective was to have the U.S. Treasury securities CCA hold the customer position margin at a safe financial institution. In addition, the rules would need to provide that the U.S. Treasury securities CCA’s account at the U.S. Federal Reserve Bank or bank be:

- Segregated from any other account of the U.S. Treasury securities CCA or any other person at the U.S. Federal Reserve Bank or bank and used exclusively to hold cash and U.S. Treasury securities to meet current margin requirements of the U.S. Treasury securities CCA resulting from positions in U.S. Treasury securities of the customers of the broker-dealer members of the qualified U.S. Treasury securities CCA;

⁵¹⁰ See Note H(b)(2)(iii) of Rule 15c3-3a, as adopted. The rule text of this paragraph has been modified to add the phrase “and qualified customer securities” after the phrase “U.S. Treasury securities” wherever the latter appears in the paragraph to conform the rule text to the modification discussed above relating to the broker-dealer’s ability to post qualified customer securities.

⁵¹¹ Proposing Release, *supra* note 14, 87 FR at 64640.

- Subject to a written notice of the U.S. Federal Reserve Bank or bank provided to and retained by the U.S. Treasury securities CCA that the cash and U.S. Treasury securities in the account are being held by the U.S. Federal Reserve Bank or bank pursuant to Rule 15c3-3 and are being kept separate from any other accounts maintained by the U.S. Treasury securities CCA or any other person at the U.S. Federal Reserve Bank or bank; and
- Subject to a written contract between the U.S. Treasury securities CCA and the U.S. Federal Reserve Bank or bank which provides that the cash and U.S. Treasury securities in the account are subject to no right, charge, security interest, lien, or claim of any kind in favor of the U.S. Federal Reserve Bank or bank or any person claiming through the U.S. Federal Reserve Bank or bank.

These conditions with respect to the account designation, written notice, and written contract would be designed to achieve the same objectives as the analogous conditions discussed above with respect to the broker-dealer's account at the U.S. Treasury securities CCA. The Commission did not receive comments on this aspect of the proposal and is adopting it substantially as proposed.⁵¹²

The fifth rule set—identified in paragraph (b)(2)(v) of Note H—provided that the customer position margin be treated in accordance with rules of the clearing agency requiring systems, controls, policies, and procedures to return customer position margin to the broker-dealer that is no longer needed to meet a current margin requirement resulting from positions in U.S. Treasury securities of the customers of the broker-dealer no later than the close of the next business day

⁵¹² See Note H(b)(2)(iv) of Rule 15c3-3a, as adopted. The rule text of this paragraph has been modified to add the phrase “and qualified customer securities” after the phrase “U.S. Treasury securities” wherever the latter appears in the paragraph to conform the rule text to the modification discussed above relating to the broker-dealer's ability to post qualified customer securities.

after the day the customer position margin is no longer needed for this purpose.⁵¹³ As discussed above, the debit would be limited to customer position margin *required* and on deposit at the U.S. Treasury securities CCA. This would mean that the broker-dealer could not include in this debit item the amount of customer position margin on deposit at the U.S. Treasury securities CCA that exceeds the broker-dealer's margin requirement resulting from its customers' cleared U.S. Treasury securities positions. The objective of this condition was to effectuate the prompt return of customer position margin to the broker-dealer.

Several commenters opposed the proposed requirement to return excess collateral within one business day.⁵¹⁴ A commenter stated that this requirement does not apply to margin posted to other clearing agencies or DCOs and does not seem to serve any customer protection benefit.⁵¹⁵ The commenter stated further that FICC does not have a mechanism to push excess margin to direct participants and direct participants do not have the capability of accepting unsolicited excess margin. Rather, similar to other clearing organizations, this commenter stated that FICC regularly notifies direct participants of excess margin every time margin is calculated and then allows such direct participants to demand a return of such margin. Furthermore, this commenter stated that some direct participants prefer to leave excess margin with FICC to serve as a buffer for future margin calls. Another commenter stated that the proposed requirement was inconsistent with other cleared products and unnecessary for customer protection.⁵¹⁶ Finally, a commenter stated that a required automatic return would add significant operational burdens, as broker-dealer participants

⁵¹³ Proposing Release, *supra* note 14, 87 FR at 64640.

⁵¹⁴ See, e.g., DTCC/FICC Letter, *supra* note 33, at 31-32; ICE Letter, *supra* note 33, at 3; SIFMA/IIB Letter, *supra* note 37, at 30.

⁵¹⁵ See DTCC/FICC Letter, *supra* note 33, at 31.

⁵¹⁶ See ICE Letter, *supra* note 33, at 3-4.

would need to update their systems to accept an automatic return of excess margin without a request and ensure that any such amounts are appropriately treated as customer assets.⁵¹⁷

The Commission agrees with commenters that the proposed requirement may add significant operational burdens to broker-dealers if a U.S. Treasury securities CCA is required to return excess collateral to a broker-dealer no later than the close of the next business day after the day the collateral is no longer needed to meet a current margin requirement resulting from positions in U.S. Treasury securities of the customers of the broker-dealer. Moreover, because the debit is limited to margin *required* and on deposit at the U.S. Treasury securities CCA, the broker-dealer has an incentive to obtain the prompt return of excess margin collateral held by the CCA that is in the form of securities. Specifically, the amount of the excess margin would remain a credit in the Rule 15c3-3a formula with no offsetting debit because the excess margin amount is no longer required by the U.S. Treasury securities CCA. Consequently, maintaining the excess margin collateral at the U.S. Treasury CCA could increase the amount that the broker-dealer must deposit into the customer reserve account.⁵¹⁸

For these reasons, the Commission is removing this aspect of the requirement from the final rule. However, the final rule retains the provision that the customer position margin is treated in accordance with rules of the clearing agency requiring systems, controls, policies, and procedures to return customer position margin to the broker-dealer that is no longer needed to meet

⁵¹⁷ See SIFMA/IIB Letter, *supra* note 37, at 30.

⁵¹⁸ See Item 15 of the Rule 15c3-3a formula, as adopted (requiring that the debit in Item 15 of the Rule 15c3-3a formula equal the margin *required* and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act resulting from the following types of transactions in U.S. Treasury securities in customer accounts that have been cleared, settled, and novated by the clearing agency: (1) purchases and sales of U.S. Treasury securities; and (2) U.S. Treasury securities repurchase and reverse repurchase agreements); *see also* Item 13 of the Rule 15c3-3a formula (requiring that the debit in Item 13 of the 15c3-3a reserve formula equal the margin *required* and on deposit with the OCC for all option contracts written or purchased in customer accounts).

a current margin requirement resulting from positions in U.S. Treasury securities of the customers of the broker-dealer.⁵¹⁹ Thus, it retains the overall objective of the proposal to effectuate the prompt return of customer position margin to the broker-dealer that is no longer needed to meet a margin requirement but leaves it to the broker-dealer and the U.S. Treasury securities CCA arrange when that amount will be returned.

**d. Fourth Condition – Commission Approval of Rules of U.S.
Treasury Securities CCA**

The fourth condition for including customer position margin as a debit in the Rule 15c3-3a formula was set forth in paragraph (b)(3) of Note H.⁵²⁰ Under this condition, the Commission would need to have approved rules of the U.S. Treasury securities CCA that meet the conditions of proposed Note H and the Commission would had to have published (and not subsequently withdrawn) a notice that brokers-dealers may include a debit in the customer reserve formula when depositing customer position margin to meet a margin requirement of the U.S. Treasury securities CCA resulting from positions in U.S. Treasury securities of the customers of the broker-dealer. The Commission staff would analyze the U.S. Treasury securities CCA's approved rules and practices regarding the treatment of customer position margin and make a recommendation as to whether they adequately implement the customer protection objectives of the conditions set forth in proposed Note H. If satisfied with the staff's recommendation, the Commission would publish a positive notice. The objective was to permit the debit only after the Commission has approved the

⁵¹⁹ See Note H(b)(2)(v) to Rule 15c3-3a, as adopted. To implement the modification discussed above, the phrase "no later than the close of the next business day after the day the cash and U.S. Treasury securities are no longer needed for this purpose" was deleted from the rule text. In addition, the rule text of this paragraph has been modified to add the phrase "and qualified customer securities" after the phrase "U.S. Treasury securities" to conform the rule text to the modification discussed above relating to the broker-dealer's ability to post qualified customer securities.

⁵²⁰ Proposing Release, *supra* note 14, 87 FR at 64640.

U.S. Treasury securities CCA’s rules pursuant to section 19(b) of the Exchange and published the notice.⁵²¹ Any changes to those rules and practices that would undermine these customer protection objectives could result in the Commission withdrawing the notice, at which point the Commission would no longer permit the debit. The Commission did not receive comments on this aspect of the proposal and is adopting it substantially as proposed.⁵²²

5. PAB Reserve Computation

Finally, broker-dealers are required to perform a separate reserve computation for PAB accounts and maintain a separate reserve account with respect to that computation.⁵²³ The Rule 15c3-3a computation provides that this separate PAB reserve computation must be performed in accordance with the Rule 15c3-3a computation for the broker-dealer’s non-PAB customers, except as provided in Notes to the PAB Computation.⁵²⁴ Therefore, the amendments discussed above adding a new debit in Item 15 would apply to the PAB reserve computation. Further, the Commission proposed to amend Note 9 Regarding the PAB Reserve Bank Account Computation—which permits a debit in the PAB reserve computation for clearing deposits required to be maintained at registered clearing agencies—to clarify that the conditions set forth in new Note H with respect to including a debit in the non-PAB customer reserve computation would

⁵²¹ See 15 U.S.C. 78s.

⁵²² See Note H(b)(3) to Rule 15c3-3a, as adopted. The rule text of this paragraph has been modified to add the phrase “and qualified customer securities” after the phrase “U.S. Treasury securities” to conform the rule text to the modification discussed above relating to the broker-dealer’s ability to post qualified customer securities.

⁵²³ See 17 CFR 240.15c3-3(a)(16) (defining the term “PAB account” to mean a proprietary securities account of a broker-dealer (which includes a foreign broker-dealer, or a foreign bank acting as a broker-dealer) other than a delivery-versus-payment account or a receipt-versus-payment account); 17 CFR 240.15c3-3(e) (requiring separate reserve accounts and reserve account computations for PAB accounts).

⁵²⁴ See 17 CFR 240.15c3-3a, Notes 1 through 10 Regarding the PAB Reserve Bank Account Computation.

apply to the PAB reserve computation as well.⁵²⁵ The Commission did not receive comments on this aspect of the proposal and is adopting it as proposed.⁵²⁶

III. Compliance Dates

In the Proposing Release, the Commission sought input from commenters on the appropriate compliance date or implementation schedule for the proposed amendments.⁵²⁷

Commenters generally supported a staged approach to implementation and compliance. Specifically, commenters stated that as a first step, the proposed requirements related to the segregation of house and customer margin (discussed in part II.B.1), access to central clearing (discussed in part II.B.2), and Rule 15c3-3 (discussed in part II.C) should become effective, and that as a second step, the proposed requirements related to clearing eligible secondary market transactions (discussed in part II.A) should become effective thereafter. Commenters also generally supported a lengthy or substantial timeframe for implementation. These comments are discussed in detail in this part.

For example, one commenter which currently is a U.S. Treasury securities CCA stated that it would take the commenter and the U.S. securities industry as a whole substantial time to make the documentation, operational, organizational, and systems changes needed to comply with the proposal, and that the commenter would need to amend its rules, which amendments the Commission would need to approve.⁵²⁸ The commenter stated that it would be advisable to adopt

⁵²⁵ Proposing Release, *supra* note 14, 87 FR at 64640.

⁵²⁶ See Rule 15c3-3a, Note 9 Regarding the PAB Reserve Bank Account Computation.

⁵²⁷ Proposing Release, *supra* note 14, 87 FR at 64641.

⁵²⁸ FICC/DTCC Letter, *supra* note 33, at v. The commenter elaborated that it will take market participants substantial time to scope the transactions subject to the requirement, execute the documentation necessary to submit such transactions for central clearing, implement internal procedures and systems to monitor and ensure compliance, and establish the relevant accounts and operational integrations with a Treasury CCA. It also stated that, concurrently, the commenter will need to develop and test the systems, operations, and documentation needed to accommodate a far greater volume of transactions, create a strategy and framework to identify and monitor compliance, and establish margin segregation arrangements. *Id.* at 27-28.

a phased implementation schedule, under which different requirements of the proposal become effective, beginning with the customer segregation requirement. The commenter stated that, depending on when any final rule is adopted, FICC and market participants may be able to implement the segregation requirement by 2025, giving market participants a full year after the expected implementation of T+1 to focus on these changes.⁵²⁹

Another commenter stated that a phased approach to implementation is necessary to ensure that the market can support a clearing mandate without undue costs to market participants and market liquidity or stability.⁵³⁰ The commenter stated that the Commission should first adopt rules to ensure that market participants have sufficient access to clearing, including changes to the access models, the segregation of house and customer margin, and changes to Rule 15c3-3. The commenter then recommended that subsequent to the Commission's adoption of such rules and FICC's implementation of the necessary corresponding changes to its access models, which would require at a minimum two years, the Commission should provide 18 months for the implementation of a tailored clearing mandate that applies to bilateral repo transactions.⁵³¹ The commenter stated that the Commission and market participants could then observe the effects of the clearing mandate in the bilateral repo market and consider whether and how to apply the mandate to triparty repo transactions.⁵³²

Another commenter stated, in considering an appropriate compliance timeframe, the Commission must build in the time necessary for: (i) FICC to work with the Commission to identify changes to its rules necessary to address the issues we have identified above with respect

⁵²⁹ FICC/DTCC Letter, *supra* note 33, at v, 28.

⁵³⁰ MFA Letter, *supra* note 81, at 21.

⁵³¹ *Id.* at 21; MFA Letter II, *supra* note 125, at 8.

⁵³² MFA Letter, *supra* note 81, at 21; *see also* MFA Letter II, *supra* note 125, at 5.

to the Sponsored Program; (ii) FICC to propose and adopt additional rules or amendments, subject to public notice and comment, that may be needed to address these issues; (iii) the Commission to propose and adopt amendments to its rules, subject to public notice and comment, and provide regulatory relief as needed to address the issues for funds that we have highlighted above; and (iv) FICC and industry participants to implement the extensive changes to policies and procedures, documentation, and operations (as detailed above for funds) that will be needed to comply with final rules.⁵³³ The commenter stated that these steps will require a significant amount of time and recommended that the Commission propose a multi-year, staged, compliance schedule, including, at a minimum, that a requirement to comply with a clearing requirement should go into effect no earlier than three years after the Commission and FICC have adopted final rules and amendments, as described in (ii) and (iii).⁵³⁴

Another commenter stated that the Commission should implement any central clearing requirement in stages and at a measured pace commensurate with the size, scope and scale of the implementation program required.⁵³⁵ The commenter stated that the Commission should work to determine an implementation that will be the least disruptive to the market and that accounts for the practical challenges that different industry participants may face as they prepare for a central clearing requirement, which may not be clear until participants are able to review any proposals from FICC regarding implementation. The commenter stated that staging implementation would allow the Commission to appropriately calibrate the costs and benefits of any requirement to clear eligible secondary market transactions and referenced that similarly significant changes to market structure (*i.e.*, triparty market reform and swaps clearing) were successfully phased-in over five or

⁵³³ ICI Letter, *supra* note 85, at 31.

⁵³⁴ ICI Letter, *supra* note 85, at 31.

⁵³⁵ SIFMA/IIB Letter, *supra* note 37, at 33.

more years to allow adequate time for market readiness while mitigating the potential for disruption.⁵³⁶

Another commenter stated that, if adopting a clearing requirement, a measured approach to implementation is required. The commenter specified that any new requirement to clear should be introduced only after enhancements to the clearing infrastructure are achieved, FICC's readiness is assured, and at least one other covered clearing agency registered with the Commission is ready to support the market in clearing eligible secondary market transactions.⁵³⁷ The commenter further stated that industry participants should have at least 18 months to engage with each CCA on the design of an appropriate clearing model that provides the minimum level of protection it described in its comment letter. The commenter also stated a timetable for clearing requirements should only be set only once sufficient consensus has emerged around the appropriate clearing model and appropriate regulatory requirements are developed. The commenter recommended that the clearing requirement should be phased in over several years based on the volume of U.S. Treasury securities transaction activity in which a market participant engages (like the phase-in approach which was followed for regulatory initial margin requirements for uncleared OTC derivatives which took more than five years following the publication of final rules to be fully implemented). The commenter stressed the importance of phasing in the new requirements in a manner that avoids too many market participants looking to finalize documentation and go-live with clearing all on the same day.⁵³⁸

⁵³⁶ ICI Letter, *supra* note 85, at 33.

⁵³⁷ SIFMA AMG Letter, *supra* note 35, at 15.

⁵³⁸ SIFMA AMG Letter, *supra* note 35, at 15.

The commenter also stated that a long phase-in period is essential, as there will be a significant implementation effort needed to comply with any new requirements.⁵³⁹ The commenter stated that it is difficult to estimate the potential scope of this work and the effort involved until the access models are more developed. The commenter stated that given the breadth of participation in the U.S. Treasury markets, the potential scale of the effort and time required to complete this work, implementation will take many years to complete after a final rule.⁵⁴⁰

An additional trade association commenter stated that its members would incur incredible costs as they establish numerous costly clearing relationships to ensure that all its transactions can be cleared as required, which will take a significant amount of time.⁵⁴¹ The commenter therefore recommended a compliance date of at least 30 months after the publication of any final rule in the *Federal Register*.⁵⁴² An additional commenter recognized that clearing requirements can have unintended and disruptive consequences and therefore recommended that the Commission implement the changes with respect to the segregation of house and customer margin, access models, and Rule 15c3-3 before moving forward with any expanded clearing requirements.⁵⁴³

⁵³⁹ SIFMA AMG Letter, *supra* note 35, at 15. For direct participants, these efforts would include obtaining information to classify their counterparties to determine who qualifies as an IDM, a hedge fund, or a leveraged account and negotiating clearing agreements with each hedge fund and leveraged account. For asset managers, these efforts would include implementation of documentation such as clearing agreements, give-up agreements, and related infrastructure. For managed funds, these efforts would include revisiting existing formation and distribution documentation, such as investment management agreements and investment guidelines, as they do not permit clearing activity or contemplate the clearing of U.S. Treasury securities. Buy-side firms will have to undertake a significant operational build to be able to settle and margin cleared transactions. The commenter, a trade association, stated that many of its members trade in blocks on behalf of multiple underlying accounts, and that the industry will have to consider and address how a mandatory requirement to clear would impact an asset manager's transaction allocation process where some accounts are required to clear and others are not. *Id.* at 15-16.

⁵⁴⁰ SIFMA AMG Letter, *supra* note 35, at 16.

⁵⁴¹ AIMA Letter, *supra* note 81, at 9.

⁵⁴² AIMA Letter, *supra* note 81, at 9.

⁵⁴³ CME Letter, *supra* note 81, at 8.

Finally, an additional commenter supported an extensive implementation timeframe that is appropriately prioritized and sequenced due to the breadth of the proposal, the time and resources necessary for a covered clearing agency to revise its policies and procedures, and the changes necessary for market participants' compliance. The commenter referred to tri-party market reform as a successful example of the time and sequencing involved in such a significant change.⁵⁴⁴

The Commission agrees with commenters that a phased approach to implementation and compliance would be appropriate for these amendments. As discussed in the Proposing Release, the Commission understands that the amendments to Rule 17ad-22(e)(18)(iv)(A) will likely result in a significant increase in the volume of U.S. Treasury securities transactions submitted for central clearing, including transactions of market participants that currently may not submit such transactions for central clearing.⁵⁴⁵ The Commission therefore stated its belief that additional changes with respect to the segregation of house and customer margin and access, as proposed in Rule 17ad-22(e)(6)(i) and (e)(18)(iv)(C), respectively, may be warranted. These changes were designed to improve risk management by and access to the U.S. Treasury securities CCA and would also serve to help manage the risks and facilitate access that would likely result from the requirement to clear eligible secondary market transactions.⁵⁴⁶ In addition, the Commission proposed changes to Rule 15c3-3 to facilitate implementation of the requirement to clear eligible secondary market transactions, by reducing the amount of broker-dealers cash and securities that would be needed to meet the requirements of Rule 15c3-3.⁵⁴⁷

⁵⁴⁴ BNY Mellon Letter, *supra* note 33, at 3.

⁵⁴⁵ Proposing Release, *supra* note 14, 87 FR at 64632, 64637.

⁵⁴⁶ *Id.* at 64632-33.

⁵⁴⁷ *Id.* at 64637.

The Commission continues to believe that the changes with respect to the segregation of house and customer margin, ensuring access to central clearing, and Rule 15c3-3 would help facilitate the central clearing of additional U.S. Treasury securities transactions, as will likely result when a requirement to clear eligible secondary market transactions goes into place. The Commission also agrees with the commenters, that it would be appropriate to implement those changes prior to the imposition of any clearing requirement. This would allow for the development of additional infrastructure that would support the eventual increased amount of central clearing that would occur upon the applicability of a requirement to clear eligible secondary market transactions.

To do so, the Commission is adopting a different compliance date for the amendments to Rule 17ad-22(e)(6)(i) (regarding separation of house and customer margin), 17ad-22(e)(18)(iv)(C) (regarding access), and 15c3-3 (regarding the broker-dealer customer protection rule), from the compliance date for the amendments to Rule 17ad-22(e)(18)(iv)(A) and (B) (regarding the requirements to clear eligible secondary market transactions and monitoring of the submission of such transactions). This staging would allow market participants, including U.S. Treasury securities CCAs, the opportunity to incorporate changes to their rules, systems, practices, contractual arrangements, and other documentation, prior to the applicability of a clearing requirement. It also would provide time between the implementation of structural changes to accommodate the separation of house and customer margin, the potential ability to rehypothecate margin pursuant to Rule 15c3-3, as amended, and additional access by new types of market participants, on the one hand, and the requirement for a U.S. Treasury securities CCA to require its direct participants to clear eligible secondary market transactions, on the other hand.

On the latter point, the Commission is incorporating two stages of compliance for the requirement to clear eligible secondary market transactions: the first would apply to the cash market transactions described in section (i) of the definition of an eligible secondary market transaction, and the second would apply to the repo market transactions described in section (ii) of the definition of an eligible secondary market transaction. Providing additional time for repo transactions to be centrally cleared should allow time for many market participants who are active in the repo market but do not centrally clear this volume of their transactions to plan for and implement necessary contractual arrangements and processes to manage the increase in volume of central clearing.

With respect to the changes to Rule 17ad-22(e)(6)(i) (regarding separation of house and customer margin), 17ad-22(e)(18)(iv)(C) (regarding access), and 15c3-3 (regarding the broker-dealer customer protection rule), (1) each covered clearing agency will be required to file with the Commission any proposed rule changes regarding those amendments required under Section 19(b) and/or advance notices required under Title VIII of the Dodd-Frank Act no later than 60 days following [INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*], and (2) the proposed rule changes must be effective by March 31, 2025 [15-months after a 12/2023 OCM]. With respect to the proposed changes to Rule 17ad-22(e)(18)(iv)(A) and (B) (regarding the requirements to clear eligible secondary market transactions and monitoring of the submission of such transactions), (1) each covered clearing agency will be required to file with the Commission any proposed rule changes regarding those amendments required under Section 19(b) and/or advance notices required under Title VIII of the Dodd-Frank Act no later than 150 days following [INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*], and (2) the proposed rule changes must be effective by December 31, 2025, for cash market transactions encompassed by

section (ii) of the definition of an eligible secondary market transaction, and by June 30, 2026, for repo transactions encompassed by section (i) of the definition of an eligible secondary market transactions. Compliance by the direct participants of a U.S. Treasury securities CCA with the requirement to clear eligible secondary market transactions would not be required until December 31, 2025, and June 30, 2026, respectively, for cash and repo transactions.

This staged implementation timeframe will encompass two and a half years from the time of the action set forth in this release. This amount of time is consistent with commenters who sought a staged, multi-year approach to implementation for this proposal, which, as adopted, is less extensive than what was proposed.⁵⁴⁸ It is also consistent with the comment of the existing U.S. Treasury securities CCA that stated that it and market participants would need until at least 2025 to implement any final rule, as it allows for that timeframe. Although some commenters referred to potentially longer timeframes for implementation, whether expressly (*e.g.*, by referring to some particular length of time, such as 18 months or three years after the U.S. Treasury securities CCA has updated its rules⁵⁴⁹) or more generally (*e.g.*, by referring to the need for a lengthy timeline or several years to impose clearing requirements⁵⁵⁰), the Commission believes that this timeframe would allow the benefits of greater central clearing to be achieved sooner and therefore is adopting the staged implementation timeframe discussed in this part.⁵⁵¹

⁵⁴⁸ See AIMA Letter, *supra* note 81, at 9 (seeking 30 months after publication of any final rule in the *Federal Register*).

⁵⁴⁹ See MFA Letter, *supra* note 81, at 21; ICI Letter, *supra* note 85, at 33.

⁵⁵⁰ See SIFMA/IIB Letter, *supra* note 37, at 33; BNY Mellon Letter, *supra* note 33, at 3; SIFMA AMG Letter, *supra* note 35, at 16.

⁵⁵¹ In addition, with respect to the compliance date, several commenters requested the Commission to consider interactions between the proposed rule and other recent Commission rules. In determining compliance dates, the Commission considers the benefits of the rules as well as the costs of delayed compliance dates and potential overlapping compliance dates. For the reasons discussed throughout the release, to the extent that there are costs from overlapping compliance dates, the benefits of the rule justify such costs. See *infra* parts IV.A and IV.C.2.e for a discussion of the interactions of the final rule with certain other Commission rules.

In addition, one commenter also stated its belief that, given the complexity and extent of changes that will be necessary to implement the proposal, it would be advisable to engage in a consultative process regarding the implementation timeline, with that process occurring after any adoption of the proposal because it is difficult for market participants to assess how long it will take to implement a requirement when they do not yet know with clarity the scope of the final requirement.⁵⁵² The commenter specifically stated that, after any adoption of the proposal, the Commission should require U.S. Treasury CCAs to submit to the Commission a proposed rule change, pursuant to Section 19 of the Exchange Act, containing an implementation schedule by no later than 180 days after the publication of the final rule in the *Federal Register*. The commenter stated that this would provide market participants with the ability to comment on the timing and requirements set forth in the proposed rule change with the benefit of knowing the requirements' scope, and that the Commission and the commenter could then consider those comments in adopting a final implementation schedule. The commenter stated that this kind of deliberative and consultative approach would facilitate the adoption of a realistic timeline and thereby avoid the need for successive extensions and the attendant uncertainty and disruption such shifting timelines present.⁵⁵³ However, the Commission's phased compliance timeline allows for the type of deliberation and consultation that the commenter recommends. A U.S. Treasury securities CCA will be required to submit proposed rule changes to comply with the requirements being adopted in this release, and there will be opportunity for comment on those proposals by market participants, thereby allowing for consultation about the potential impact of any such proposed rule changes.

⁵⁵² FICC/DTCC Letter, *supra* note 33, at v.

⁵⁵³ FICC/DTCC Letter, *supra* note 33, at v.

IV. Economic Analysis

The Commission is mindful of the economic effects that may result from these amendments, including the benefits, costs, and the effects on efficiency, competition, and capital formation. Exchange Act section 3(f) requires the Commission, when it is engaged in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.⁵⁵⁴ In addition, Exchange Act section 23(a)(2) requires the Commission, when making rules pursuant to the Exchange Act, to consider among other matters the impact that any such rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.⁵⁵⁵

The Commission is adopting amendments to its rules that impose additional requirements for any U.S. Treasury securities CCA.⁵⁵⁶ First, the amendments require that U.S. Treasury securities CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, establish objective, risk-based, and publicly disclosed criteria for participation, which require that the direct participants of such covered clearing agency submit for clearance and settlement all of the eligible secondary market transactions to which they are a counterparty.⁵⁵⁷ In addition, the amendments require that such CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, identify and monitor its direct participants' required submission of transactions for clearing,

⁵⁵⁴ See 15 U.S.C. 78c(f).

⁵⁵⁵ See 15 U.S.C. 78w(a)(2).

⁵⁵⁶ See part II *supra*.

⁵⁵⁷ See part II.A.1 and part II.A.2 *supra* for a description of the requirement to clear eligible secondary market transactions including the definition of "eligible secondary market transaction."

including, at a minimum, policies and procedures that address any failures to submit transactions.⁵⁵⁸ Strengthening the membership standards will help reduce contagion risk to U.S. Treasury securities CCAs and bring the benefits of central clearing to more transactions involving U.S. Treasury securities, thereby lowering the risk of disruptions to the U.S. Treasury securities market.⁵⁵⁹

Second, the Commission is adopting additional requirements on how U.S. Treasury securities CCAs calculate, collect, and hold margin posted on behalf of indirect participants (*i.e.*, customers) who rely on the services of a direct participant (*i.e.*, the member of the U.S. Treasury securities CCA) to access the CCA's services.⁵⁶⁰ As discussed in more detail below, such requirements also will improve the risk management practices at U.S. Treasury securities CCAs and incentivize and facilitate additional central clearing in the U.S. Treasury securities market.

Third, the Commission is adopting amendments that will require that a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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 its board of directors reviews these policies and procedures annually.⁵⁶¹ Although these requirements do not prescribe specific methods for market participants to obtain indirect access to a U.S. Treasury securities CCA, they are intended to help ensure that all U.S. Treasury security CCAs review their indirect access models and ensure that they facilitate access to clearance and settlement services in a manner

⁵⁵⁸ See part II.A.4 *supra*.

⁵⁵⁹ See part IV.A *infra*.

⁵⁶⁰ See part II.C *supra*.

⁵⁶¹ See part II.B.2 *supra*.

suited to the needs and regulatory requirements of market participants throughout the U.S. Treasury securities market, including indirect participants.

Lastly, the Commission is amending its rules to permit margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula, subject to certain conditions.⁵⁶² As discussed further below, these amendments to its rules, in conjunction with the amendments requiring the separation of house and customer margin, should incentivize and facilitate additional central clearing in the U.S. Treasury securities market.

The discussion of the economic effects of the rule amendments begins with a discussion of the risks inherent in the clearance and settlement process and how the use of a CCP can mitigate those risks. This is followed by a baseline of current U.S. Treasury securities market practices. The economic analysis then discusses the likely economic effects of the rule amendments, as well as their effects on efficiency, competition, and capital formation. The Commission has, where practicable, attempted to quantify the economic effects expected to result from these rule amendments. In some cases, however, data needed to quantify these economic effects is not currently available. For example, prior to the proposal the reporting of data for bilaterally cleared repo transactions was not a regulatory requirement, so counterparty-specific statistics were not available and any aggregate statistics on this market segment may not have been comprehensive.⁵⁶³ In the intervening period, and as discussed further below, the Department of the Treasury's Office of Financial Research (OFR) has reported the results of a pilot data collection of non-centrally

⁵⁶² See part II.C *supra*.

⁵⁶³ Samuel J. Hempel, R. Jay Kahn, Vy Nguyen, and Sharon Y. Ross, *Non-Centrally Cleared Bilateral Repo*, THE OFR BLOG (Aug. 24, 2022) ("Hempel et al. (2022)"), available at <https://www.financialresearch.gov/the-ofr-blog/2022/08/24/non-centrally-cleared-bilateral-repo/>.

cleared bilateral repo.⁵⁶⁴ Likewise, the reporting of U.S. Treasury securities transactions to TRACE has been until recently⁵⁶⁵ limited to cash transactions in which at least one of the counterparties is a FINRA member, so analyses based on that data will necessarily be incomplete.

In many cases, and as noted below, the Commission is unable to quantify the economic effects of the rule amendments and in the proposal solicited comment, including estimates and data from interested parties, to help inform the estimates of the economic effects of the proposal. As discussed further below, several commenters stated the importance of further research and to better understand the potential intended and unintended impacts of the rule. Although many of the commenters calling for additional research did not provide additional data or propose how any remaining uncertainty might be resolved, as discussed below, some commenters did provide limited data on quantifiable costs.⁵⁶⁶

Costs and benefits will depend in part on how market participants access central clearing in order to clear eligible secondary market transactions. As some commenters have highlighted, the current clearing framework may need to be changed and extended to support the requirement to clear eligible secondary market transactions. The Commission agrees that changes to the current

⁵⁶⁴ See part IV.B.3.b.ii *infra*. See also Samuel J. Hempel, R. Jay Kahn, Robert Mann, and Mark Paddrik, *Why Is So Much Repo Not Centrally Cleared?*, OFR BRIEF (May 12, 2023) (“Hempel et al. (2023)”), available at <https://www.financialresearch.gov/briefs/2023/05/12/why-is-so-much-repo-not-centrally-cleared/>. The OFR has also proposed rulemaking mandating the collection of daily transaction level data from certain financial companies on their non-centrally cleared bilateral repurchase agreement trades. See Office of Financial Research, *Office of Financial Research Releases Proposal to Collect Data on Certain Repo Transactions* (Jan. 5, 2023), available at <https://www.financialresearch.gov/press-releases/2023/01/05/office-of-financial-research-releases-proposal-to-collect-data-on-certain-repo-transactions/>.

⁵⁶⁵ Reporting of additional cash transactions to TRACE, by certain U.S. and foreign banks, began on Sept. 1, 2022, but the recent nature of that change makes it difficult to draw conclusions from the limited data available. See generally Federal Reserve System, *Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB*, 86 FR 59716 (Oct. 28, 2021); see also Bd. Governors Fed. Rsrv. Sys., *Supporting Statement for the Treasury Securities and Agency Debt and Mortgage-Backed Securities Reporting Requirements*, FEDERALRESERVE.GOV, available at <https://www.federalreserve.gov/reportforms/formsreview/FR%202956%20OMB%20SS.pdf> (last visited Dec. 11, 2023).

⁵⁶⁶ See part IV.C.2 *infra*.

clearing framework are necessary and therefore is adopting as proposed Rule 17ad-22(e)(18)(iv)(C) that requires that a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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, which policies and procedures the U.S. Treasury securities CCA's board of directors reviews annually.

A. Broad Economic Considerations

Clearance and settlement risk is the risk that a counterparty fails to deliver a security or cash as agreed upon at the time when the security was traded. One method of reducing such risk is to require one or both counterparties to the trade to post collateral.⁵⁶⁷ The purpose of posting collateral in financial transactions is to alleviate frictions caused by adverse selection and moral hazard.⁵⁶⁸ The amount of collateral needed to support a set of unsettled trades, however, can depend on whether trades are cleared bilaterally or through a CCP. In cases where market participants have several outstanding buy and sell orders, central clearing reduces the total collateral required to support a given set of trades due to multilateral netting.⁵⁶⁹ A simple example

⁵⁶⁷ An alternative method of reducing counterparty credit risk is delivery versus payment (“DVP”). Under DVP, counterparties aim to deliver securities and payment simultaneously, so that the transfer of securities happens if and only if payment has also been made.

⁵⁶⁸ For example, if the fulfillment of a contract depends on a counterparty exerting unobservable and costly effort, collateral can be used as a commitment device by putting more of the counterparty's resources at stake in the case of nonfulfillment. See Bengt Holmstrom & Jean Tirole, *Financial Intermediation, Loanable Funds, and the Real Sector*, 112 Q. J. ECON. 663 (Aug. 1997); Albert J. Menkveld & Guillaume Vuillemeys, *The Economics of Central Clearing*, 13 ANN. REV. FIN. ECON. 153, 158 (2021).

⁵⁶⁹ Darrell Duffie & Haoxiang Zhu, *Does a Central Clearing Counterparty Reduce Counterparty Risk?* 1 REV. ASSET PRICING STUD. 74 (2011), available at <https://academic.oup.com/raps/article-abstract/1/1/74/1528254>. The authors note that this benefit scales with the square root of the number of participants when the trading positions are statistically independent and identically distributed. The authors also note certain conditions that can impact netting efficiencies, e.g., when cross asset netting is allowed in non-centrally cleared markets, asset specific CCPs can negatively impact netting efficiency. We also note, as discussed below, that certain aspects of client clearing models can impact netting efficiency.

illustrates the effect. Suppose there are 3 firms trying to complete three bilateral trades among themselves. Firm A is buying \$90 million in U.S. Treasury securities from Firm B, Firm B is buying \$80 million in the same U.S. Treasury securities from Firm C, and Firm C is buying \$100 million in the same U.S. Treasury securities from Firm A. This means that over the settlement cycle, the firms in this example would need to post collateral to cover a total of \$270 million in gross obligations to complete these three trades. If these trades were centrally cleared, however, then the *net* obligations would be substantially smaller. In this example, the collateral required would no longer be that required to support \$270 million in outstanding obligations, but instead would reduce to \$40 million: \$20 million for Firm C, and \$10 million each for Firms A and B.⁵⁷⁰ Central clearing can, in part, replace a trading network made up of a web of bilateral relationships with a simpler hub and spoke model. As each connection is a potential source of failure, a simpler system can imply less risk.

Clearance and settlement through a CCP can also make trades less “informationally sensitive” in the sense that the value of the trade does not depend on information about the creditworthiness of the counterparties, thereby reducing adverse selection.⁵⁷¹ This occurs when the trade is novated to the CCP, and the CCP becomes the buyer to every seller and the seller to every buyer. This reduces the need for investors to acquire private information about the credit risk of their counterparty. By mitigating adverse selection through the substitution of the CCP’s counterparty credit risk evaluation for a market participant’s own, central clearing through a CCP lowers the cost of trading by market participants and should increase their willingness to trade,

⁵⁷⁰ This example is from Duffie, *supra* note 27.

⁵⁷¹ See Gary Gorton & George Pennacchi, *Financial Intermediaries and Liquidity Creation*, 45 J. FIN. 49 (1990); see also Francesca Carapella & David Mills, *Information Insensitive Securities: the Benefits of Central Counterparties* (N.Y. Fed, working paper Oct. 17, 2012), available at https://www.newyorkfed.org/medialibrary/media/research/conference/2012/MP_Workshop/Carapella_Mills_information_insensitive_securities.pdf.

thereby improving market liquidity. Reducing the information sensitivity of trades also increases the uniformity of the asset that is traded. In the absence of novation, the U.S. Treasury security is essentially bundled together with counterparty risk. That is, when buying or selling a security, if there is counterparty risk, the pricing depends not only on the security itself but also on the reliability of the counterparty to the trade. It is as if, from an economic perspective, one is “buying” both the security and the characteristics of the counterparty. Besides the reduction in adverse selection, reducing counterparty credit risk makes the security a more standard product. Standardization itself increases liquidity.⁵⁷²

Financial networks that incorporate a CCP can further improve the resilience of financial markets. The Bank for International Settlements stated in 2015 that the shift to central clearing had helped to mitigate the risks that emerged in non-centrally cleared markets before and during the 2007-2009 financial crisis. Further, it had reduced financial institutions’ exposure to counterparty credit risk shocks through netting, margining and collateralization.⁵⁷³

Another potential benefit of central clearing is it should reduce the magnitude of, or even prevent, fire sales of assets. This mitigation of fire sale risk is achieved when a member defaults and the CCP manages the liquidation of assets. Central management of asset liquidation may mitigate suboptimal outcomes in the face of capital or margin constraints. For example, if investors believe the counterparty will sell in the case of a missed margin call, other investors may join the selloff, leading to further declines in asset prices. If market participants can pledge to not sell, then a more efficient equilibrium in which there is no fire sale could be achieved. In this way,

⁵⁷² See Ben Bernanke, *Clearing and Settlement During the Crash*, 3 REV. FIN. STUD. 133 (1990).

⁵⁷³ Dietrich Domanski, Leonardo Gambacorta, and Cristina Picillo, *Central clearing: trends and current issues*, BIS Q. REV. (Dec. 2015), available at https://www.bis.org/publ/qtrpdf/r_qt1512g.pdf.

the CCP acts as a way to select into the more efficient equilibrium by allowing members to credibly pre-commit to the coordinated liquidation of assets in the case of a missed margin call.⁵⁷⁴

Finally, broadening central clearing could lead to a wider group of liquidity providers, which likely would increase the reliability of access to funding during periods of market stress.⁵⁷⁵ The reason is that novation of the trade to a central counterparty reduces one of the major reasons for not doing business with a particular counterparty: the risk that that counterparty may fail to deliver on its obligations. It also reduces one of the reasons for failing to provide liquidity, namely concerns over the credit risk of counterparties. Therefore, as a result of increased levels of central clearing and the resulting increased centralization of counterparty credit risk evaluation by a CCP and the CCP's application of consistent and transparent risk management,⁵⁷⁶ more counterparties – who would also be potential liquidity providers – would be willing to compete to provide liquidity to buy-side investors and to each other. In addition, several academic studies following the 2008 financial crisis emphasize the role of intermediary balance sheet constraints as a cause of financial crises.⁵⁷⁷ Moreover, losses experienced by market participants can lead to an increase in risk aversion leading those market participants to exit, creating a need for new market participants to

⁵⁷⁴ John Chi-Fong Kuong, *Self-Fulfilling Fire Sales: Fragility of Collateralized Short-Term Debt Markets*, 34 REV. FIN. STUD. 2910 (2021), available at <https://academic.oup.com/rfs/article/34/6/2910/5918033?login=true>.

⁵⁷⁵ G-30 Report, *supra* note 5, at 13.

⁵⁷⁶ See TMPG White Paper, *supra* note 13 (“[b]ilateral clearing involves varying risk management practices that are less uniform and less transparent to the broader market...”). In addition, FICC has been designated by FSOC as a systemically important financial market utility, which brings heightened risk management requirements and additional regulatory supervision by both its primary regulator and the Board of Governors. See also U.S. DEPT. OF THE TREASURY, FIN. STABILITY OVERSIGHT COUNCIL, 2012 ANNUAL REPORT, APP. A, available at <https://home.treasury.gov/system/files/261/2012-Annual-Report.pdf> (“FSOC 2012 Annual Report”).

⁵⁷⁷ See e.g., Markus K. Brunnermeier & Yuliy Sannikov, *A Macroeconomic Model with a Financial Sector*, 104 AM. ECON. REV. 379 (Feb. 2014); see also Zhiguo He & Arvind Krishnamurthy, *Intermediary Asset Pricing*, 103 AM. ECO. REV. 732 (Apr. 2013). Balance sheet constraints and the impact of losses on risk aversion both affect the ability and willingness of market participants to provide liquidity. A CCP is not similarly affected as it does not supply liquidity.

replace them in order to provide liquidity.⁵⁷⁸ Therefore, either because of increased risk aversion or because some friction implies that the liquidity providers who find themselves warehousing the asset can no longer do so due to trading losses, outside liquidity providers may play an important role in stabilizing the market. In addition, central clearing facilitates anonymized all-to-all trading that would enable the provision of market liquidity by investors.^{579, 580}

Several commenters were generally supportive of benefits of central clearing. One commenter stated that it, “...supports central clearing because, when calibrated appropriately, it has increased resiliency, liquidity and transparency in financial markets.”⁵⁸¹ Another commenter stated that “[i]f implemented thoughtfully, increased central clearing of Treasury cash and repurchase (“repo”) transactions will reduce systemic risk and meaningfully improve counterparty risk management, market liquidity, and resiliency.”⁵⁸² Several additional commenters made similar statements.⁵⁸³

Several commenters, including some who were generally supportive of the benefits of central clearing, referenced the need to do additional study before imposing any requirement on U.S. Treasury securities CCAs for their participants to clear and settle eligible secondary market

⁵⁷⁸ See, e.g., John Y. Campbell & John H. Cochrane, *By Force of Habit: A Consumption-Based Explanation of Aggregate Stock Market Behavior*, 107 J. POL. ECON. 205 (Apr. 1999).

⁵⁷⁹ G-30 Report, *supra* note 5, at 13. See also Duffie, *supra* note 27, at 4 (“Further, given broad access to a CCP, some Treasury transactions could flow directly from ultimate sellers to ultimate buyers without necessarily impinging on dealer balance sheet space.”).

⁵⁸⁰ The market responded to the stress of 2020 through some increase in all-to-all trading. See MarketAxess, FIMSAC Slides, at 6 (Oct. 5, 2020), available at <https://www.sec.gov/spotlight/fixed-income-advisory-committee/mcvey-fimsac-slides-100120.pdf> Additional central clearing may have enabled a greater increase.

⁵⁸¹ AIMA Letter, *supra* note 81, at 2.

⁵⁸² Citadel Letter, *supra* note 81, at 1.

⁵⁸³ See AIMA Letter, *supra* note 81, at 2; CME Group, *supra* note 81, at 2; DTCC/FICC Letter, *supra* note 33, at 1; GTS Letter, *supra* note 81, at 3; ISDA Letter, *supra* note 391, at 2; LSEG Letter, *supra* note 33, at 2; MFA Letter, *supra* note 81, at 2; ARB Trading et al. Letter, *supra* note 81, at 1; SIFMA/IIB Letter, *supra* note 37, at 1; Sunthay Letter, *supra* note 33, at 4; Tradeweb Letter, *supra* note 81, at 2; Better Markets Letter, *supra* note 33, at 8; ICE Letter, *supra* note 33, at 1.

transactions. One commenter stated that the Commission should conduct detailed analysis on the costs and benefits of central clearing across market segments and participant types, as well as analyze the overall impact on Treasury market liquidity. The commenter stated that it is widely recognized within existing literature on Treasury market structure reform that further detailed study is needed in this area. The commenter also stated that increased central clearing resulting from incentives to centrally clear U.S. Treasury securities transactions would provide additional data for this analysis.⁵⁸⁴

In support of its claim that it is widely recognized within existing literature on Treasury market structure reform that further study is needed, the commenter cites two working papers.⁵⁸⁵ The first citation includes a quote stating that it would be difficult to estimate the amount of liquidity savings associated with central clearing without further study.⁵⁸⁶ However, the cited work is generally supportive of central clearing, stating that “Without a broad central clearing mandate, the size of the Treasury market will outstrip the capacity of dealers to safely intermediate the market on their own balance sheets, raising doubts over the safe-haven status of U.S. Treasuries and concerns over the cost to taxpayers of financing growing federal deficits.”⁵⁸⁷

The second citation provided by the commenter also focuses on the potential benefit of improved liquidity.⁵⁸⁸ The working paper states that a potential mandate for wider use of central clearing for Treasury securities is the second of four complementary measures for enhancing the

⁵⁸⁴ SIFMA/IIB Letter, *supra* note 37, at 2.

⁵⁸⁵ SIFMA/IIB Letter, *supra* note 37, at 2 (citing working papers by Duffie, *supra* note 27, and Liang and Parkinson, *supra* note 28).

⁵⁸⁶ *Id.* at 2.

⁵⁸⁷ Duffie, *supra* note 27, at 1.

⁵⁸⁸ Liang and Parkinson, *supra* note 28.

liquidity of U.S. Treasury markets when under stress.⁵⁸⁹ The cited work also does not address the potential benefits of increased central clearing other than the potential for improved liquidity. Immediately following the authors’ statement in favor of further study, they state that “If such a study were to conclude that expanded clearing is not appropriate for Treasury securities, it should explain what distinguishes Treasury markets from the many other markets, such as equities and Treasury futures, for which there is a clearing mandate.”⁵⁹⁰

Another commenter stated that the Commission should substantiate the benefits and potential costs of clearing through additional studies and data. The commenter stated that the Commission’s proposal should be considered after the Commission has had an opportunity to gather additional data and further assess whether increased clearing is the best way to mitigate the risks confronting the U.S. Treasury market, including a more in-depth understanding of how these changes will affect the costs of transactions for institutional investors who depend on access to these markets for active portfolio management and, as a result, represent a significant source of market liquidity.⁵⁹¹ In addition, one commenter, which surveyed market participants as the basis of its comment, conveyed a “strong belief that insufficient review and examination has been given to the proposal by the official sector and that such work needs to be detailed and focused to properly vet a mixture of economic, operational, legal and market challenges before the proposal is enacted.”⁵⁹²

⁵⁸⁹ *Id.*

⁵⁹⁰ *Id.* at 3.

⁵⁹¹ SIFMA AMG Letter, *supra* note 37, at 2-3.

⁵⁹² SIA Partners Comment, *supra* note 52, at 8.

The Commission has reviewed the academic literature on central clearing as well as the reports published by the G-30, the TMPG, the OFR, and others⁵⁹³ and does not agree with commenters that suggest that additional study should precede adoption of a requirement for U.S. Treasury securities CCAs to obligate direct participants to clear eligible secondary market transactions. Although the Commission recognizes that some of the benefits of additional central clearing of eligible secondary market transactions may be mitigated for certain transactions,⁵⁹⁴ the Commission has consulted with other regulators regarding this proposal and believes it has performed sufficient analysis in both the Proposing Release and in this release to consider the costs and benefits arising from its proposal.

As discussed in more detail throughout this release, and especially in part IV.C *infra*, the Commission understands that the costs associated with the requirement to clear eligible secondary market transactions will vary depending on how a market participant is able to and/or chooses to access central clearing. The degree to which market participants have increased costs will depend largely on whether and how they currently access central clearing, and therefore, costs likely will vary greatly across different types of market participants. For example, for certain indirect

⁵⁹³ See, e.g., Duffie, *supra* note 27; Duffie and Zhu, *supra* note 569; Duffie, *infra* note 718; Duffie et al., *infra* note 718; G-30 Report, *supra* note 5; TMPG White Paper, *supra* note 13; TMPG Repo White Paper, *supra* note 75; Hempel et al. (2022), *supra* note 563; Hempel et al. (2023), *supra* note 564; Kahn & Olson, *supra* note 628; 2017 OFR Report, *infra* note 797; 2021 IAWG Report, *supra* note 4; 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, *Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report* (Nov. (2023), *supra* note 564; Kahn & Olson, *supra* note 628; 2017 OFR Report, *infra* note 797; 2021 IAWG Report, *supra* note 4; 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, *Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report* (Nov. 2022), available at <https://home.treasury.gov/system/files/136/2022-IAWG-Treasury-Report.pdf> (“2022 IAWG 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, *Enhancing the Resilience of the U.S. Treasury Market: 2023 Staff Progress Report* (Nov. 2023), available at https://home.treasury.gov/system/files/136/20231106_IAWG_report.pdf (“2023 IAWG Report”); 2017 Treasury Report, *infra* note 736; Joint Staff Report, *supra* note 4.

⁵⁹⁴ See, e.g., part IV.B.5 *infra*.

participants whose transactions with direct participants of a U.S. Treasury securities CCA are not submitted for central clearing currently, the costs of establishing some indirect participant relationship, whether through FICC's Sponsored Service or some other client clearing model, may be high. In addition, following the initial costs, the ongoing costs of submitting transactions for central clearing, such as posting margin and paying fees to a direct participant which facilitates access, may also be high.⁵⁹⁵

However, benefits will accrue from the requirement to submit for clearing and settlement eligible secondary market transactions. As discussed earlier in this section and in part IV.C.1 *supra*, one of the several cited benefits of additional central clearing is the increased resiliency of centrally cleared markets. The economic costs of market disruptions can be high so market changes that decrease the probability of such events by even a small amount can result in a large expected economic benefit. Discussion of disruptions in the U.S. Treasury Securities Market over the last decade typically discuss the size of the market and interconnectedness of the U.S. Treasuries markets with other financial markets as evidence of their importance; estimates of the cost to the U.S. economy as a result of these disruptions are less common.⁵⁹⁶ However, there is evidence that the costs of extreme financial crises can be high.⁵⁹⁷

⁵⁹⁵ See part IV.C.2.a.ii *infra*.

⁵⁹⁶ See part IV.B.6 *infra*, for a discussion of the Mar. 2020, Sept. 2019, and Oct. 2014 market disruptions. See SEC Staff Report on U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock (Oct. 2020), *supra* note 280, for discussion of the interconnectedness of financial crisis and market disruptions.

⁵⁹⁷ Barnichon et al., estimate that “the 2007–08 financial crisis persistently lowered output by roughly 7 percentage points. This is a large number: In dollar terms, it represents a lifetime income loss in present-discounted value terms of about \$70,000 for every American.” Regis Barnichon, Christian Matthes, and Alexander Ziegenbein, *The Financial Crisis at 10: Will We Ever Recover?*, FRBSF Econ. Letter 2018-19 (Aug. 13, 2018), available at https://www.frbsf.org/economic-research/publications/economic-letter/2018/august/financial-crisis-at-10-years-will-we-ever-recover/?utm_source=frbsf-home-economic-letter-title&utm_medium=frbsf&utm_campaign=economic-letter. Romer and Romer (2017) study a panel of countries in the Organization for Economic Co-operation and Development and find that gross domestic

In addition, the requirement for direct participants to clear such transactions will reduce risk to the U.S. Treasury securities CCA, by reducing counterparty risk and enabling additional multilateral netting and centralized default management, as discussed in part II.A.1 *supra*. Further, to the extent that implementation costs arise from changes to the CCA’s rules, the CCA’s implementation of the requirement will provide further opportunity to consider the costs and benefits of particular methods of implementation. Because CCAs are self-regulatory organizations, any rule changes to implement the requirement will need to be reviewed by the Commission,⁵⁹⁸ and commenters will be able to comment on the particular changes and issues raised by such changes, including costs and benefits.

B. Baseline

The baseline against which the costs, benefits, and the effects on efficiency, competition, and capital formation of the final rule are measured consists of the current state of the market for U.S. Treasury securities, including the repo market, current practice as it relates to the purchase and sale of U.S. Treasury securities, and the current regulatory framework. The economic analysis considers existing regulatory requirements, including recently adopted rules, as part of its economic baseline against which the costs and benefits of the final rule are measured.⁵⁹⁹

product is typically about 9 percentage points lower five years after an extreme financial crisis. Christina Romer and David Romer, *New Evidence on the Aftermath of Financial Crises in Advanced Countries*, 107 AM. ECON. REV. 3,072 (Oct. 2017).

⁵⁹⁸ See Exchange Act section 19(b) and Rule 19b-4.

⁵⁹⁹ See, e.g., *Nasdaq v. SEC*, 34 F.4th 1105, 1111-15 (D.C. Cir. 2022). This approach also follows SEC staff guidance on economic analysis for rulemaking. See SEC Staff, *Current Guidance on Economic Analysis in SEC Rulemaking* (Mar. 16, 2012), available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf (“The economic consequences of proposed rules (potential costs and benefits including effects on efficiency, competition, and capital formation) should be measured against a baseline, which is the best assessment of how the world would look in the absence of the proposed action.”); *id.* at 7 (“The baseline includes both the economic attributes of the relevant market and the existing regulatory structure.”). The best assessment of how the world would look in the absence of the proposed or final action typically does not include recently proposed actions, because that would improperly assume the adoption of those proposed actions.

Certain commenters requested the Commission to consider interactions between the economic effects of the proposed rule and other recent Commission proposals.⁶⁰⁰ The Commission recently adopted six of the proposed rules mentioned by commenters as potentially impacting the economic effects of the final rule,⁶⁰¹ namely the May 2023 SEC Form PF Amending Release,⁶⁰² Private Fund Advisers Adopting Release,⁶⁰³ Beneficial Ownership Amending

⁶⁰⁰ Letter from Eric Pan, Pres. & CEO, and Susan Olsen, General Counsel, Investment Company Institute at 1 (Aug. 17, 2023) (“ICI Letter 2”) (“The Commission has issued a wide range of interconnected rule proposals . . . [that] in the aggregate warrant further analysis by the Commission.”); Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association at 6 (July 21, 2023) (“MFA Letter 2”) (“the Commission should holistically examine all of the pending Proposals, consider the potential overlap between them, and . . . evaluat[e] the costs and benefits of the Proposals in light of one another.”); *see also* ARB et al. Letter, *supra* note 81, at 9 (“the Commission has simultaneously put forward multiple proposals designed to achieve [] objectives without considering how these various proposals interact with each other.”); *cf.* AIMA Letter II, *supra* note 115, at 4 (“Together, the Treasury Clearing Proposal and ATS Proposal render the [then-proposed amendments to the definition of dealer] unnecessary.”).

⁶⁰¹ Those six proposals are: Amendments to *Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and large Liquidity Fund Advisers*, Release No. IA-5950 (Jan. 26, 2022) 87 FR 9106 (Feb 17, 2022) (*see* MFA Letter 2, *supra* note 600, at 10-12); *Modernization of Beneficial Ownership Reporting*, Release Nos. 33-11030, 34-94211 (Feb. 10, 2022), 87 FR 13846 (Mar. 10, 2022) (*see* MFA Letter 2, *supra* note 600, at 14-15); *Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-94313 (Feb. 25, 2022), 87 FR 14950 (Mar. 16, 2022) (*see* MFA Letter 2, *supra* note 600, at 15-16); *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-5955 (Feb. 9, 2022), 87 FR 16886 (Mar. 24, 2022) (*see* MFA Letter 2, *supra* note 600, *passim*); *Prohibition Against Conflicts of Interest in Certain Securitizations*, Release No. 33-11151 (Jan. 25, 2023), 88 FR 9678 (Feb. 14, 2023) (*see* MFA Letter 2, *supra* note 600, at 21-22); *Outsourcing by Investment Advisers*, Release No. IA-6176 (Oct. 26, 2022), 87 FR 68816 (Nov. 16, 2022) (*see* MFA Letter 2, *supra* note 600, at 17-18).

⁶⁰² *Form PF; Event Reporting for Large Hedge Fund Advisers and Private Equity Fund Advisers; Requirements for Large Private Equity Fund Adviser Reporting*, Release No. IA-6297 (May 3, 2023) 88 FR 38146 (June 12, 2023) (“May 2023 SEC Form PF Amending Release”). The Form PF amendments require large hedge fund advisers and all private equity fund advisers to file reports upon the occurrence of certain reporting events. The compliance dates are Dec. 11, 2023, for the event reports in Form PF sections 5 and 6, and June 11, 2024, for the remainder of the Form PF amendments.

⁶⁰³ *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-6383 (Aug. 23, 2023), 88 FR 63206 (Sept. 14, 2023) (“Private Fund Advisers Adopting Release”). The Private Fund Advisers Adopting Release includes new rules designed to protect investors who directly or indirectly invest in private funds by increasing visibility into certain practices and restricting other practices, along with amendments to the Advisers Act books and records rule and compliance rule. The amended Advisers Act compliance provision for registered investment advisers has a Nov. 13, 2023, compliance date. The compliance date is Mar. 14, 2025, for the rule’s quarterly statement and audit requirements for registered investment advisers with private fund clients. For the rule’s adviser-led secondaries, restricted activity, and preferential treatment requirements, the compliance date is Sept. 14, 2024, for larger advisers and Mar. 14, 2025, for smaller advisers. *See* Private Fund Advisers Adopting Release, sections IV, VI.C.1.

Release,⁶⁰⁴ the Rule 10c-1a Adopting Release,⁶⁰⁵ the Short Position Reporting Adopting Release,⁶⁰⁶ and the Securitizations Conflicts Adopting Release.⁶⁰⁷ These rules were not included as part of the baseline in the Proposing Release because they had not been adopted at that time. In response to commenters, this economic analysis considers potential economic effects arising from

⁶⁰⁴ *Modernization of Beneficial Ownership Reporting*, Release No. 33-11253 (Oct. 10, 2023), 88 FR 76896 (Nov. 7, 2023) (“Beneficial Ownership Amending Release”). Among other things, the amendments shorten the filing deadlines for beneficial ownership reports filed on Schedule 13D and Schedule 13G. The compliance dates are 90 days after publication in the *Federal Register*, for Schedule 13D amended filing deadlines; Sept. 30, 2024, for the Schedule 13G amended filing deadlines; and Dec. 18, 2024, for the structured data requirement.

⁶⁰⁵ *Reporting of Securities Loans*, Release No. 34-98737 (Oct. 13, 2023), 88 FR 75644 (Nov. 3, 2023) (“Rule 10c-1a Adopting Release”). The securities loan reporting rule requires any person who loans a security on behalf of itself or another person to report information about securities loans to a registered national securities association (namely, FINRA) and requires FINRA to make certain information it receives available to the public. The covered persons will include market intermediaries, securities lenders, broker-dealers, and reporting agents. The final rule’s compliance dates require that FINRA propose its rules within four months of the effective date of final Rule 10c-1a, or approximately May 2024, and finalize them no later than 12 months after the effective date of final Rule 10c-1a, or approximately Jan. 2025; that FINRA implement data retention and availability requirements for reporting 24 months after the effective date of final Rule 10c-1a, or approximately Jan. 2026; that covered persons report Rule 10c-1a information to FINRA starting on the first business day thereafter; and that FINRA publicly report Rule 10c-1a information within 90 calendar days thereafter, or approximately Apr. 2026. See Rule 10c-1a Adopting Release, section VIII, at 75691.

⁶⁰⁶ *Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-98738 (Oct. 13, 2023), 88 FR 75100 (Nov. 1, 2023) (“Short Position Reporting Adopting Release”). The new rule and related form are designed to provide greater transparency through the publication of short sale-related data to investors and other market participants. Under the new rule, institutional investment managers that meet or exceed certain specified reporting thresholds are required to report, on a monthly basis using the related form, specified short position data and short activity data for equity securities. The compliance date for the rule is 12 months after the effective date of the release, which will be approximately Jan. 2025. In addition, the Short Position Reporting Adopting Release amends the national market system plan governing CAT to require the reporting of reliance on the bona fide market making exception in the Commission’s short sale rules. The compliance date for the CAT amendments is 18 months after the effective date, or approximately July 2025.

⁶⁰⁷ *Prohibition Against Conflicts of Interest in Certain Securitizations*, Release No. 33-11254 (Nov. 27, 2023), 88 FR 85396 (Dec. 7, 2023) (“Securitizations Conflicts Adopting Release”). The new rule prohibits an underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security (ABS) (including a synthetic ABS), or certain affiliates or subsidiaries of any such entity, from engaging in any transaction that would involve or result in certain material conflicts of interest. The compliance date is 18 months after publication in the *Federal Register*, or June 9, 2025.

any overlap between the compliance period for the final amendments and these recently adopted rules.⁶⁰⁸

1. U.S. Treasury Securities

U.S. Treasury securities are direct obligations of the U.S. Government issued by the U.S. Department of the Treasury. After issuance in the primary market U.S. Treasury securities trade in an active secondary market.⁶⁰⁹ A number of types of market participants intermediate between investors in U.S. Treasury securities. These investors hold U.S. Treasury securities as a relatively riskless way of saving, as a way of placing a directional bet on interest rates, or as a means of hedging against deflation. U.S. Treasury securities can also function directly as a medium of exchange in some instances, and, as described in more detail below, as collateral for loans.

Market participants refer to the most recently issued U.S. Treasury securities as “on-the-run,” with earlier issues referred to as “off-the-run”.⁶¹⁰ Figure 1 shows the outstanding value of on-

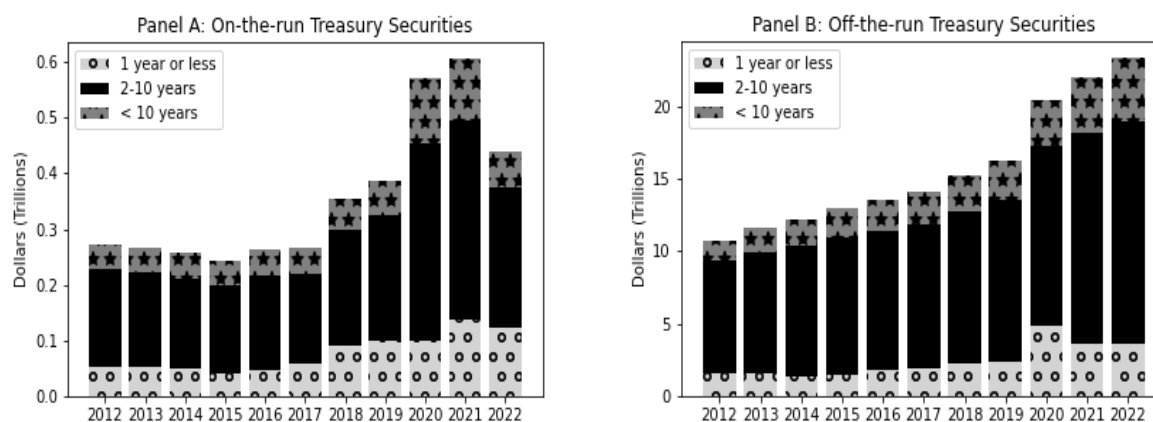
⁶⁰⁸ In addition, commenters indicated there could also be overlapping compliance costs between the final amendments and proposals that have not been adopted. *See, e.g.,* ICI Letter 2, *supra* note 600, at 8 n.13. To the extent those proposals are adopted, the baseline in those subsequent rulemakings will reflect the existing regulatory requirements at that time.

⁶⁰⁹ There is also an active market for U.S. Treasury securities that trade on a “when-issued” (WI) basis. “Based on Treasury TRACE transactions data, WI trading volume averaged \$80 billion per day between July 1, 2019, and June 30, 2020, accounting for 12% of the \$651 billion traded daily across all Treasury securities.” *See* Michael Fleming, Or Shachar, and Peter Van Tassel, *Treasury Market When-Issued Trading Activity*, LIBERTY STREET ECONOMICS BLOG (Nov. 30, 2020), *available at* <https://libertystreeteconomics.newyorkfed.org/2020/11/treasury-market-when-issued-trading-activity/>. As discussed in the Proposing Release, *supra* note 14, 87 FR at 64615, for purposes of this rulemaking only the WI market after the auction but before issuance (WI on-the-run issues) is considered part of the secondary market for U.S. Treasury securities. Most of the WI trading in the Fleming, Shachar, and Van Tassel analysis occurred in on-the-run issues. (“WI trading that occurs up to and including the auction day (account[s] for about one-third of WI trading) and WI trading that occurs after the auction day (account[s] for about two-thirds of WI trading”).) For a discussion of how WI trading functions in the context of central clearing, *see* Kenneth D. Garbade & Jeffrey F. Ingber, *The Treasury Auction Process: Objectives, Structure, and Recent Adaptations*, 11 CURRENT ISSUES ECON. & FIN. 1 (2005), *available at* https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci11-2.html.

⁶¹⁰ On-the-run U.S. Treasury securities are the most recently auctioned nominal coupon securities. These securities are referred to as “on-the-run” starting the day after they are auctioned. Nominal coupon securities pay a fixed semi-annual coupon and are currently issued at original maturities of 2, 3, 5, 7, 10, 20, and 30 years. These standard maturities are commonly referred to as “benchmark” securities because the yields for these securities are used as references to price a number of private market transactions.

the-run (Panel A) and off-the-run (Panel B) U.S. Treasury securities. On-the-run U.S. Treasury securities have consistently made up approximately 3% of the total value of all marketable U.S. Treasury securities during the 2012-2022 period, but, as Figure 3 shows, account for a disproportionate share of trading volume. Thus, an on-the-run security is generally far more liquid than a similar off-the-run security.

Figure 1: On-the-run and off-the-run U.S. Treasury securities (trillions)^a



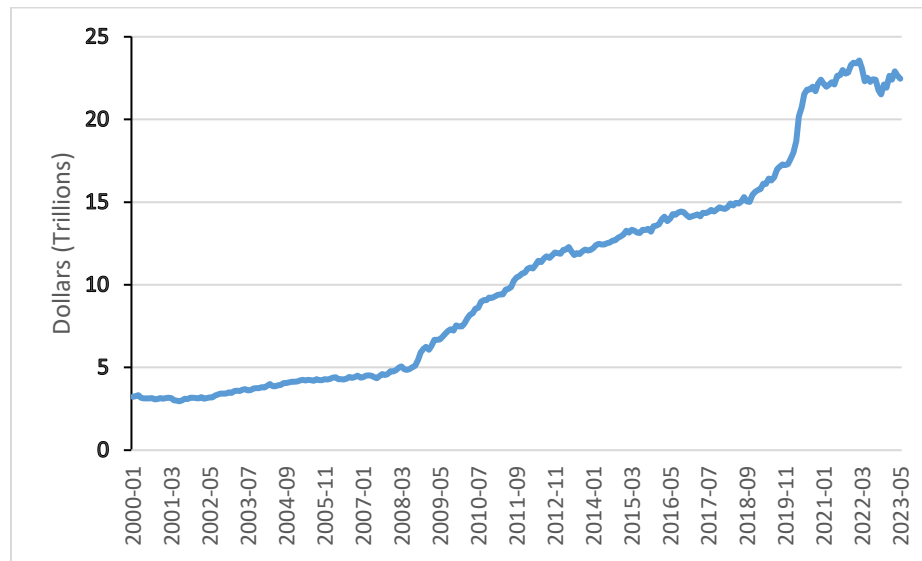
^a Source: Calculated from U.S. Treasury Monthly Statement of the Public Debt (MSPD). See DEP'T OF THE TREAS., MSPD (2023), available at <https://fiscaldata.treasury.gov/datasets/monthly-statement-public-debt/detail-of-marketable-treasury-securities-outstanding>.

As of November 2023, the total market value outstanding of marketable U.S. Treasury securities held by the public was \$26.3 trillion.⁶¹¹ As shown in Figure 2, the value of marketable U.S. Treasury securities outstanding has increased by approximately \$19 trillion since 2000. The total amount of marketable U.S. Treasury securities issued during 2022 was \$17.4 trillion.⁶¹²

⁶¹¹ See SIFMA US Treasury Securities Statistics, available at <https://www.sifma.org/resources/research/us-treasury-securities-statistics/>.

⁶¹² U.S. Treasury, *Debt Position and Activity Report* (July 31, 2023), available at <https://www.treasurydirect.gov/government/public-debt-reports/debt-position-and-activity-report/>.

Figure 2: Market Value of Marketable U.S. Treasury Securities Outstanding Over Time^a



^a **Source:** Federal Reserve Bank of Dallas, Market Value of Marketable Treasury Debt [MVMTD027MNFRBDAL], retrieved from FRED, Federal Reserve Bank of St. Louis, *available at* <https://fred.stlouisfed.org/series/MVMTD027MNFRBDAL> (retrieved on Aug. 7, 2023).

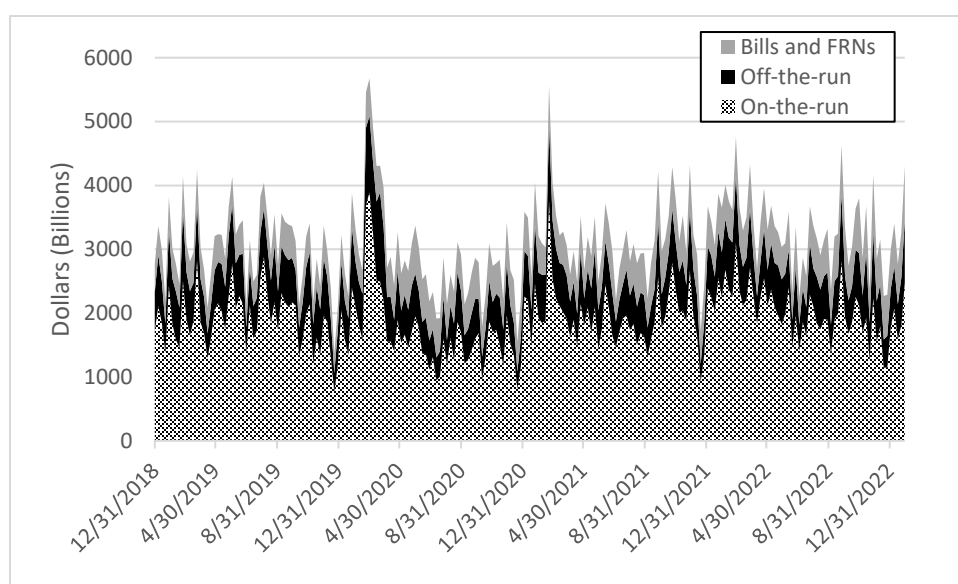
In the primary market, the Treasury Department auctions securities (*i.e.*, debt) to the public through a competitive bidding process and subsequently issues awarded securities to finance the Federal Government.⁶¹³ Financial institutions designated by the Federal Reserve Bank of New York as “primary dealers” are expected to submit competitive bids on a pro-rata basis and participate meaningfully in all U.S. Treasury auctions at reasonably competitive rates or yields.⁶¹⁴ The Treasury Department typically issues U.S. Treasury securities a few days after the auction and

⁶¹³ TMPG White Paper, *supra* note 13, at 6. The Federal Reserve Bank of New York serves as fiscal agent for the U.S. Treasury in conducting auctions of marketable U.S. Treasury debt. *See* 12 U.S.C. 391.

⁶¹⁴ *See* Federal Reserve Bank of New York, Administration of Relationships with Primary Dealers, *available at* <https://www.newyorkfed.org/markets/primarydealers.html>. Specifically, primary dealers are required to be either (1) a registered broker-dealer or government securities broker-dealer, which is approved as a member of the Financial Industry Regulatory Authority, Inc. and has net regulatory capital of at least \$50 million, or (2) a state or federally chartered bank or savings association (or a state or federally licensed branch or agency of a foreign bank) that is subject to bank supervision and maintains at least \$1 billion in Tier 1 capital. *Id.* Thus, for those primary dealers that fall into the former category, they are a subset of the broader set of registered broker-dealers or government securities broker-dealers.

trade on the secondary market.⁶¹⁵ The subsequent trading of U.S. Treasury securities is defined as the secondary market. Figure 3 reports weekly trading values in the secondary market for U.S. Treasury securities. According to industry reports, 67% of the \$913.2 billion in average daily trading volume of U.S. fixed income securities in 2022 was in U.S. Treasury securities.⁶¹⁶ As shown in Figure 3, average weekly trading volume was approximately \$3 trillion in 2022, with notable peaks in March 2020 and early 2021.⁶¹⁷

Figure 3: Weekly trading volume in U.S. Treasury securities cash market^a



^a Source: TRACE Weekly Aggregate Statistics, available at <https://www.finra.org/finra-data/browse-catalog/about-treasury/weekly-data>. Floating Rate Notes (“FRNs”) are U.S. Treasury Securities with a maturity of two years at issuance, pay interest four times each year and have an interest rate that may change over time. Treasury bills are short-dated debt with a maturity of one year or less, sold at a discount to face value, and that pay interest at maturity.

⁶¹⁵ The Treasury Department typically announces a new security that it intends to sell several days before the auction at which it is first sold to the public. These securities begin trading after announcement before the auction and through issuance, which occurs a few days after the auction. Such trading is known generally as “when-issued” trading; however, in the timeframe between the announcement and the auction, such trading is known as when-issued and referred to as such by market participants, but after the auction and before issuance, the securities are typically referred to simply as on-the-run, consistent with market practice. See Fleming et. al. *supra* note 609.

⁶¹⁶ Another 26% was Agency MBS, 4% corporate debt, with the remainder in municipal, non-agency mortgage-backed, Federal agency debt and asset-backed securities. SIFMA, *US Fixed Income Securities Statistics* (last updated Aug. 7, 2023), available at <https://www.sifma.org/resources/research/us-fixed-income-securities-statistics/>.

⁶¹⁷ *Id.*

2. U.S. Treasury Repurchase Transactions

A U.S. Treasury repurchase transaction generally refers to a transaction in which one market participant sells a U.S. Treasury security to another market participant and commits to repurchase the security at a specified price on a specified later date.⁶¹⁸ Because one side of the transaction receives cash, and the other side receives securities, to be returned at a later date, the transaction is a sale and purchase of securities that is economically similar to borrowing cash against securities as collateral. The amount the lender pays for the security in the initial leg may be less than the market price. The difference between the market price and the price paid divided by the market price of the collateral is known as the “haircut.” A positive haircut implies that the loan is over-collateralized: the collateral is worth more than the cash that is loaned. A related term is “initial margin” – the ratio of the purchase price to the market value of the collateral.

General collateral repurchases are an important variation on the above type of transaction, where one participant purchases from a class, not a specific issue, of U.S. Treasury securities.⁶¹⁹ U.S. Treasury repo for a specific asset is generally a bilaterally settled arrangement, whereas general collateral repurchases are usually settled with a third agent, known as a triparty agent. In bilaterally settled repo arrangements (bilateral repo), the repo buyer has the title to the specific asset in question and can sell or re-hypothecate it. In repo that is settled through a triparty agent

⁶¹⁸ See *supra* note 74.

⁶¹⁹ More specifically, general collateral is a set of security issues which trade in the repo market at the same or a very similar repo rate. These security issues can therefore be substituted for one another without changing the repo rate. In other words, the buyer in a general collateral repo is indifferent to which of the general collateral securities she will receive. The basket of security issues that form a particular general collateral repo market belong to the same class (e.g., government bonds) or sub-class (e.g., government bonds with no more than five years remaining to maturity). See International Capital Market Association, [FAQ] 8. *What is General Collateral (GC)?*, ICMA ERCC Publications (Jan. 2019), available at <https://www.icmagroup.org/market-practice-and-regulatory-policy/repo-and-collateral-markets/icma-ercc-publications/frequently-asked-questions-on-repo/8-what-is-general-collateral-gc>.

(triparty repo), which is discussed below, the repo buyer has more limited use of the collateral. However, this collateral is often re-hypothecated within the same triparty system; namely, a buyer may use the securities purchased from the seller for its own reverse repo transaction.

As described in the Proposing Release, repurchase agreements are generally classified by the term over which they take place, either “overnight” or “term.”⁶²⁰ In overnight repurchase agreements, the repurchase of the security takes place the day after the initial purchase, meaning that these agreements serve, essentially, as overnight loans collateralized by U.S. Treasury securities. Term repurchase agreements, conversely, take place over a longer horizon.⁶²¹

U.S. Treasury repo has various economic uses. First, it is analogous to secured borrowing and lending, allowing some market participants to, in effect, turn their U.S. Treasury securities into cash positions, and others to temporarily invest cash that is not in use in a way that mitigates exposure to, for example, the counterparty risk of a depository institution. Bilateral repo can allow market participants to effectively price interest rate expectations into bonds, and to arbitrage differences in the market prices of closely related U.S. Treasury securities, because it provides financing for U.S. Treasury security purchases and facilitates short sales.

Repos also play a role in monetary policy. The Federal Reserve operates a reverse repurchase facility in which it receives cash from eligible market participants in exchange for collateral consisting of U.S. Treasury securities. The interest rate on these repurchase agreements

⁶²⁰ See Proposing Release, *supra* note 14, 87 FR at 64616.

⁶²¹ Overnight repurchase agreements account for 87.5% of daily transaction volume. See Figure 5 and the associated discussion for more details. In addition to term repo agreements with fixed maturity dates, there exist term repurchase agreements with embedded options that lead to an uncertain maturity date. For example, “callable” repos include an option for the lender to call back debt (*i.e.*, resell securities) at its discretion. “Open” repos have no defined term but rather allow either party to close out the contract at any date after initiation of the agreement.

is the overnight reverse repurchase offer rate set by the Federal Reserve to aid implementation of monetary policy by firming up the floor for the effective Federal funds rate.⁶²²

There is some evidence of dealer concentration in repo markets. In a December 2019 report, the BIS reported that as repo rates rose above the interest rate on excess reserves in mid-2018, the four largest U.S. banks appeared to have turned into the marginal lender in repo markets.⁶²³ However, in 2021 the Federal Reserve Bank of New York economists reported that the secured funding portion of the repo market is competitive.⁶²⁴ Using data on centrally cleared U.S. Treasury repo transactions and all triparty settled transactions, the New York Fed economists filtered the data using the same filters used in the construction of SOFR in order to eliminate transactions likely driven by considerations other than secured funding and then reported measures of dealer concentration.⁶²⁵ The authors report that the top 5 (10) dealers comprise 44.2 (63.6) percent of repo selling (cash-lending) activity and 40.2 (56.7) percent of repo purchasing (cash-

⁶²² See Federal Reserve Bank of New York, *Monetary Policy Implementation*, available at <https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation>.

⁶²³ See Fernando Avalos, Torsten Ehlers and Egemen Eren, *September stress in dollar repo markets: passing or structural?*, BIS Q. REV. (Dec. 2019), available at https://www.bis.org/publ/qtrpdf/r_qt1912v.htm. Up to July 28, 2021, interest was paid at an IORR (interest on required reserves) rate and at an IOER (interest on excess reserves) rate. The IORR rate was paid on balances maintained to satisfy reserve balance requirements, and the IOER rate was paid on excess balances. Effective Mar. 24, 2020, the Board amended Regulation D to set all reserve requirement ratios for transaction accounts to 0%, eliminating all reserve requirements. To account for those changes, the Board approved a final rule amending Regulation D to replace references to an IORR rate and to an IOER rate with references to a single IORB (interest rate on required balance) rate. See Board of Governors of the Federal Reserve, *Interest on Reserve Balances (IORB) Frequently Asked Questions* (July 29, 2021), available at <https://www.federalreserve.gov/monetarypolicy/iorb-faqs.htm>.

⁶²⁴ Adam Copeland, R. Jay Kahn, Antoine Martin, Matthew McCormick, William Riordan, Kevin Clark, and Tim Wessel, *How Competitive are U.S. Treasury Repo Markets?*, Federal Reserve Bank of New York Liberty Street Economics (Feb. 18, 2021), available at <https://libertystreeteconomics.newyorkfed.org/2021/02/how-competitive-are-us-treasury-repo-markets/#:~:text=In%20contrast%2C%20the%20GCF%20Repo,both%20sides%20of%20the%20market>.

⁶²⁵ Among other filters, transactions to which the Federal Reserve is a counterparty are excluded. See *Additional Information about Reference Rates Administered by the New York Fed*, Federal Reserve Bank of New York (Jan. 24, 2022), available at https://www.newyorkfed.org/markets/reference-rates/additional-information-about-reference-rates#treasury_repo_data_exclusions.

borrowing) activity and conclude that the centrally cleared and triparty portion of the repo market is less concentrated than might appear from the BIS study.⁶²⁶

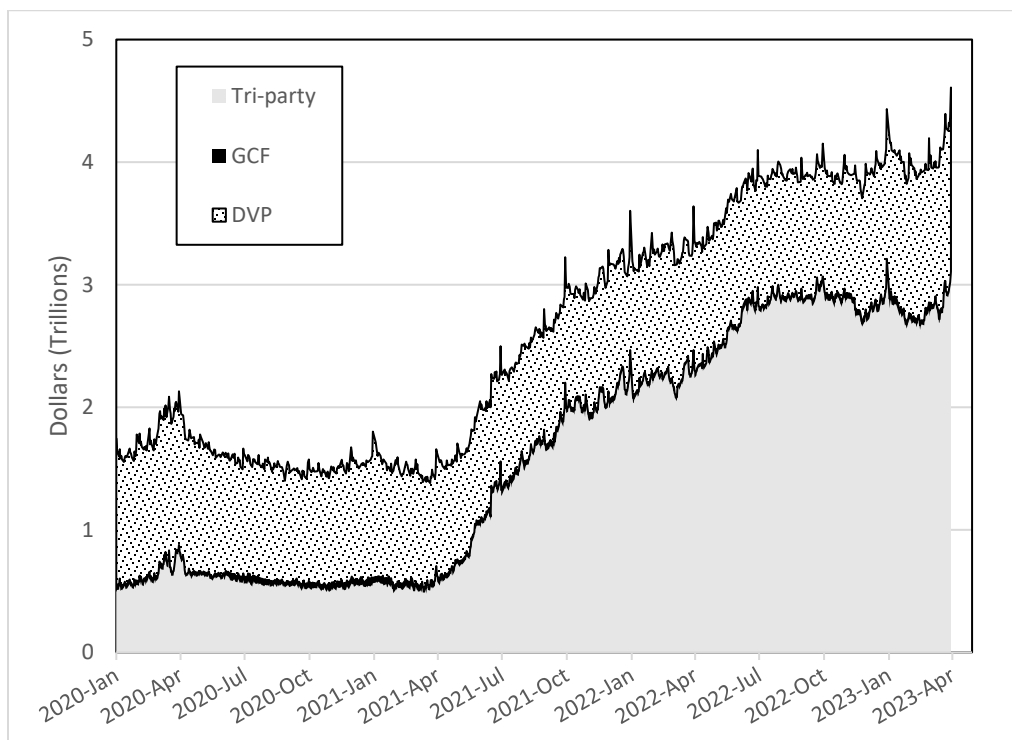
The market for repos is dominated by large, sophisticated institutions, at least as compared to the cash market. The institutions that participate in the market for repos are also those for whom access to central clearing may be the least costly economically. Relatedly, although difficult to quantify precisely, the number of participants is one or more orders of magnitude greater in the cash market as compared with the repo market: e.g., tens of thousands as opposed to thousands. As Figure 4 shows, the U.S. Treasury securities repurchase market is large; throughout 2020 and through May of 2021, daily transaction volume of repo that was either centrally cleared or settled on the triparty platform ranged between \$1.4 and \$2.1 trillion per day. Since May 2021, the daily volume has increased considerably – as high as \$4.6 trillion per day – coinciding with the growth in the Federal Reserve’s overnight reverse repurchase operations. Figure 4 further splits these totals into three categories based on 3 of the 4 repo market components discussed in part IV.B.3.b *supra*: non-centrally cleared triparty, FICC DVP Service, and FICC GCF Repo Service.⁶²⁷ Despite steadily increasing volumes of centrally cleared repurchase transactions, due in part to the development of services to enable acceptance of more types of repurchase transactions at the

⁶²⁶ See *supra* note 623. The New York Fed makes available data on top 3 dealer concentration (*see Tri-Party/GCF Repo*, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo#interactive/concentration> (last visited Dec. 12, 2023)) in the tri-party/GCF repo segment; however, the New York Fed’s statistics treat its own Overnight Reverse Repo Facility as a dealer. Since the use of this facility has grown from zero to \$2.2 trillion since 2021 Q1, the New York Fed’s data on the concentration of the top 3 “dealers” is difficult to interpret and is not included here.

⁶²⁷ Figure 4 does not include bilateral repo transactions – including most inter-affiliate transactions – that are not settled on the tri-party platform or centrally cleared through FICC for which comprehensive data is not currently available. Trades resulting from the Federal Reserve Bank of New York’s standing repo facility and reverse repo facility are cleared and settled on the tri-party platform and are included in Figure 4. See Federal Reserve Bank of New York, *FAQs: Standing Repo Facility* (July 26, 2023), available at <https://www.newyorkfed.org/markets/repo-agreement-ops-faq> and Federal Reserve Bank of New York, *FAQs: Reverse Repurchase Agreement Operations* (July 26, 2023), available at https://www.newyorkfed.org/markets/rrp_faq.

covered clearing agency, the Commission understands that the volume of bilateral repurchase transactions that are cleared and settled directly between the two counterparties remains substantial, representing approximately half of all bilateral repurchase transactions in 2021.⁶²⁸

Figure 4: Daily U.S. Treasury Repurchase Transaction Volume^a



^a Figure 4 includes only transactions that are settled on the triparty platform or bilateral repo that is centrally cleared. Source: Office of Financial Research Short-term Funding Monitor – Data Sets, U.S. Repo Markets Data Release, refreshed daily, available at <https://www.financialresearch.gov/short-term-funding-monitor/datasets/repo/>. See also IAWG Report, *supra* note 4, at 29.

The triparty segment of the U.S. Treasury securities repurchase agreement market is large, with an average of approximately \$575 billion of daily trading volume in 2020, and has taken on a substantially larger role since the beginning of 2021, peaking at approximately \$3.1 trillion in transaction volume in the March of 2023.⁶²⁹ Of this, overnight repos is the largest segment,

⁶²⁸ See R. Jay Kahn & Luke M. Olson, *Who Participates in Cleared Repo?*, OFR BRIEF SERIES (July 8, 2021), available at https://www.financialresearch.gov/briefs/files/OFRBr_21-01_Repo.pdf.

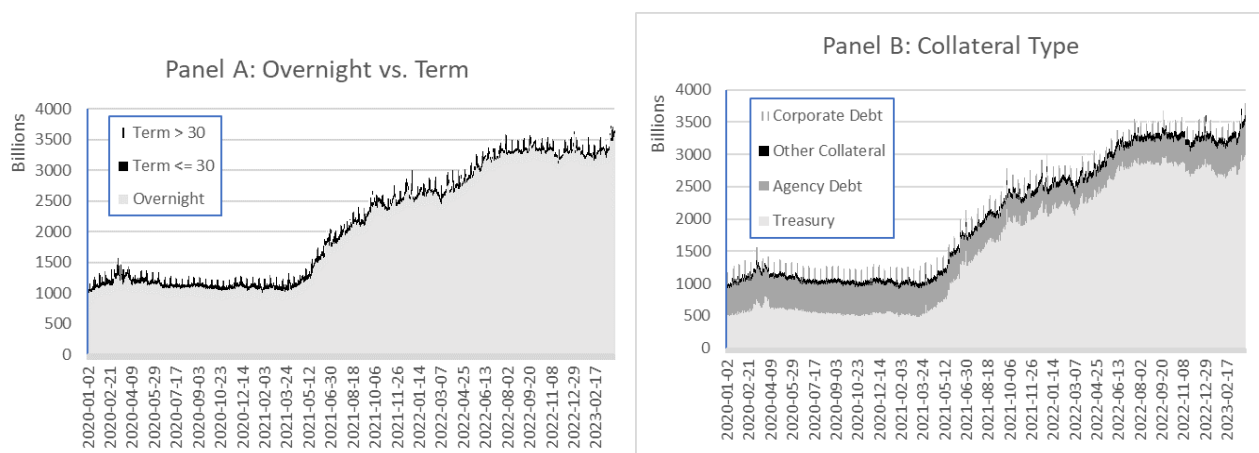
⁶²⁹ See Figure 4.

making up 92% on average of daily transaction volume since 2020, as shown in Figure 5.

Although different types of securities are used as collateral in triparty repos, over 70% of daily volume of triparty repo since 2020 are transactions with U.S. Treasury securities as collateral.⁶³⁰

The remainder are agency securities, referring to mortgage-backed securities issued by U.S government agencies and government sponsored enterprises, and various other securities including corporate bonds, non-U.S. sovereign debt, equity, municipal debt, and commercial paper.⁶³¹

Figure 5: Triparty Repurchase Agreement Trading Volume, Splits^a



^a Office of Financial Research Short-term Funding Monitor – Data Sets, U.S. Repo Markets Data Release, refreshed daily, available at <https://www.financialresearch.gov/short-term-funding-monitor/datasets/repo/>.

3. Clearance and Settlement of U.S. Treasury Security Transactions

The secondary market includes the “cash market,” for outright purchases and sales of securities, and the repo market, where one participant sells a U.S. Treasury security to another

⁶³⁰ See Figure 5.

⁶³¹ See Mark E. Paddrik, Carlos A. Ramirez, & Matthew J. McCormick, *The Dynamics of the U.S. Overnight Triparty Repo Market* (FEDS Notes, Aug. 2, 2021), available at <https://www.federalreserve.gov/econres/notes/feds-notes/the-dynamics-of-the-us-overnight-triparty-repomarket-20210802.htm>.

participant and commits to repurchase the security at a specified price on a specified later date.⁶³² These rule amendments and new rules apply to the secondary market for U.S. Treasury securities.

a. Cash Market

The cash market has two main components: the interdealer market and the dealer-to-customer market. In the interdealer market, dealers primarily trade with each other and with principal trading firms (“PTFs”), which trade as principals for their own accounts. In the dealer-to-customer market, dealers trade with their customers.

i. Interdealer

The majority of trading in the interdealer market in on-the-run U.S. Treasury securities occurs on trading platforms operated by IDBs, as described in part II.A.2.b.ii, *supra*.⁶³³ These IDBs are generally direct participants of a U.S. Treasury securities CCA and stand as counterparties to both sides of each trade on their platforms.⁶³⁴

The majority of trades in the interdealer markets are trades in “on-the-run” issues. The majority of interdealer trading for off-the-run U.S. Treasury securities occurs via bilateral transactions through traditional voice-assisted brokers and electronic trading platforms offering various protocols to bring together buyers and sellers, although some interdealer trading in off-the-run U.S. Treasury securities does occur on IDBs that anonymously bring together buyers and sellers.⁶³⁵

⁶³² See 2021 IAWG Report, *supra* note 4, at 3. The secondary market also includes the market for U.S. Treasury futures, which trade electronically on the Chicago Board of Trade, a designated contract market operated by the Chicago Mercantile Exchange (“CME”) Group, and centrally cleared by CME Clearing. U.S. Treasury futures are generally regulated by the U.S. Commodity Futures Trading Commission.

⁶³³ Joint Staff Report, *supra* note 4, at 11, 35-36.

⁶³⁴ 2021 IAWG Report, *supra* note 4, at 21.

⁶³⁵ Joint Staff Report, *supra* note 4, at 35.

Most IDBs are FICC direct participants, and the trades between an IDB, which is a FICC direct participant, and another FICC direct participant are submitted for central clearing to FICC, which, as discussed below, is currently the only U.S. Treasury securities CCA. Direct participants of FICC are generally either dealers (both bank-affiliated and independent) or banks. FICC's current rules generally require that FICC direct participants submit for clearing all trades with other FICC direct participants.⁶³⁶ However, FICC's rules do not require that a trade between a FICC direct participant and a party that is not a FICC direct participant be submitted for clearing. Therefore, for trades on IDBs between a party that is not a FICC direct participant (which, on an IDB, is generally a PTF) and a dealer that is a FICC direct participant – which results in two separate transactions, between the IDB and the dealer, on the one hand, and between the IDB and the PTF, on the other hand – the transaction between the dealer and the IDB would be centrally cleared. But the transaction between a PTF which is not a FICC member and the IDB, on the other side, would not be centrally cleared and instead would be settled bilaterally with the IDB, often through a clearing agent acting on behalf of the non-FICC direct participant.⁶³⁷

Estimates from the first half of 2017 further suggest that only 13 percent of the cash transactions in the U.S. Treasury securities market are centrally cleared. These estimates suggest that another 19 percent of transactions in this market are subject to so-called hybrid clearing in

⁶³⁶ FICC Rule 2A section 7(e) (requirement that FICC Netting Members submit to FICC all of its eligible trades with other Netting Members); FICC Rule 18 section 2 (similar requirement with regard to Repo transactions), *supra* note 19.

⁶³⁷ See TMPG White Paper, *supra* note 13, at Figures 5A and 5B (providing graphical description of this type of clearing).

which one leg of a transaction facilitated by an IDB platform is centrally cleared and the other leg of the transaction is cleared bilaterally.⁶³⁸

Until the mid-2000s, most inter-dealer trading occurred between primary dealers who were FICC members and thus was centrally cleared.⁶³⁹ Today, PTFs actively buy and sell large volumes of U.S. Treasury securities on an intraday basis using high-speed and other algorithmic trading strategies.⁶⁴⁰ PTFs are not generally FICC members and, as such, their trades are often not centrally cleared. Moreover, PTFs compose a substantial portion of trading volume, averaging about 20% of overall U.S. Treasury cash market volume and accounting for around 50-60% of IDB volume in outright purchases and sales of U.S. Treasury securities.⁶⁴¹ Primary dealers, who are FICC members and who transact the 40-50% of IDB volume not accounted for by PTFs, are required by Federal Reserve Bank of New York policy to centrally clear their U.S. Treasury securities primary market cash activity.⁶⁴²

As Tables 1 and 2 below show, during the 6-month period ending in June 2023 trading volume of on-the-run U.S. Treasury securities was approximately two and half times that of off-

⁶³⁸ See 2021 IAWG Report, *supra* note 4, at 30; see also TMPG White Paper, *supra* note 13, at 12. The figures are estimated using FR 2004 data covering the first half of 2017 and are based on various assumptions: a) primary dealers account for all dealer activity, b) 5% of dealers' trading not through an IDB is with another dealer, c) the shares of dealer and non-dealer activity in the IDB market for coupon securities equal the weighted averages of the shares reported in the Oct. 15 report (that is, 41.5% and 58.5%, respectively), d) only dealers trade bills, FRNs, and TIPS in the IDB market, and e) the likelihood of dealer and non-dealers trading with one another in the IDB market solely reflects their shares of overall volume. Commission staff understands that these assumptions may be less appropriate for more recent time periods (*e.g.*, PTFs are responsible for a growing share of IDB activity).

⁶³⁹ See G-30 Report, *supra* note 5; 2021 IAWG Report, *supra* note 4, at 5-6; TMPG White Paper, *supra* note 13, at 6.

⁶⁴⁰ See Joint Staff Report, *supra* note 4, at 1, 8, 32, 35-36, 39.

⁶⁴¹ See James Collin Harkrader & Michael Puglia, *Principal Trading Firm Activity in Treasury Cash Markets* (FEDS Notes, Aug. 2020) ("Harkrader and Puglia FEDS Notes"), available at <https://www.federalreserve.gov/econres/notes/feds-notes/principal-trading-firm-activity-in-treasury-cash-markets-20200804.htm>.

⁶⁴² See Federal Reserve Bank of New York, *Administration of Relationships with Primary Dealers*, available at <https://www.newyorkfed.org/markets/primarydealers.html>.

the-run U.S. Treasury securities. Over half (57.9%) of on-the-run U.S. Treasury security trading volume and approximately one quarter (22.9%) of off-the-run U.S. Treasury security trading volume occurred on ATSs (which are also IDBs) and non-ATS IDBs.⁶⁴³ Of the on-the-run U.S. Treasury security trading volume that occurred on ATS IDBs and non-ATS IDBs, 34.0% were dealer trades, 18.4% were PTF trades, and the remainder were customer trades. For off-the-run trading in U.S. Treasury securities, the comparable figures are 19.0% dealer trades, 1.2% PTF trades, and the remainder are customer trades. In contrast to trades that take place on an ATS or a non-ATS IDB, 42.0% of on-the-run U.S. Treasury security transactions and 77.1% of off-the-run U.S. Treasury security transactions are traded bilaterally. The majority of these (78.5% of on-the-run and 84.3% of off-the-run) are dealer-to-customer trades.

Bilaterally cleared trades make up 87% of total trading in the secondary U.S. Treasury securities market, making them the most prevalent trade type in the market.⁶⁴⁴ These trades include at least one party that is not a netting member of the single U.S. Treasury securities CCA. The bilateral clearing process comes with risks. After the trade is executed, the principals to the trade face counterparty credit risk, in the event that either party fails to deliver on its obligations.⁶⁴⁵

⁶⁴³ The term “IDB” typically refers only to IDBs that are also ATSs. The entities referred to as IDBs here are encompassed in the ATSs category in the tables set forth in this section because of the way that such IDBs are categorized in TRACE. Specifically, the “ATS” category in TRACE encompasses these IDBs. By contrast, the non-ATS IDBs category in TRACE encompasses the voice-based or other non-anonymous methods of bringing together buyers and sellers, which are also sometimes referred to as interdealer brokers by market participants.

⁶⁴⁴ TMPG White Paper, *supra* note 13, at 12. This figure is estimated from 2017H1 data and includes approximately 19% hybrid clearing. As reported by TMPG, the estimates are based on various assumptions: a) primary dealers account for all dealer activity, b) 5% of dealers’ trading not through an IDB is with another dealer, c) the shares of dealer and non-dealer activity in the IDB market for coupon securities equal the weighted averages of the shares reported in the Oct. 15 report (that is, 41.5% and 58.5%, respectively), d) only dealers trade bills, FRNs, and TIPS in the IDB market, and e) the likelihood of dealer and non-dealers trading with one another in the IDB market solely reflects their shares of overall volume. Commission staff understands that these assumptions may be less appropriate for more recent time periods (*e.g.*, PTFs are responsible for a growing share of IDB activity).

⁶⁴⁵ TMPG White Paper, *supra* note 13, at 13.

Table 1: On-the-run U.S. Treasury Securities Trading Volume

On-the-Run U.S. Treasury Securities Trading Volume			
	Num. of Venues	Average Weekly Volume (\$M)	Volume Share (%)
<u>ATSS</u>	<u>16</u>	<u>874,284</u>	<u>49.4</u>
Customer trades	12	38,338	2.2
Dealer trades	16	510,296	28.8
PTF trades	7	325,649	18.4
<u>Non-ATS Interdealer Brokers</u>	<u>24</u>	<u>151,353</u>	<u>8.5</u>
Customer trades	22	59,639	3.4
Dealer trades	23	91,714	5.2
<u>Bilateral dealer-to-dealer trades</u>	<u>283</u>	<u>159,760</u>	<u>9.0</u>
<u>Bilateral dealer-to-customer trades</u>	<u>521</u>	<u>584,832</u>	<u>33.0</u>
<u>Total</u>	-	<u>1,770,229</u>	<u>100.0</u>
<p>This table reports trading volume and volume share for ATSS,^a Non-ATS interdealer brokers, bilateral dealer-to-dealer transactions, bilateral dealer-to-customer, and bilateral dealer-to-PTF transactions for on-the-run U.S. Treasury Securities. On-the-run U.S. Treasury Securities are the most recently issued nominal coupon securities and Treasury Inflation Protected Securities (TIPS). Nominal coupon securities pay a fixed semi-annual coupon and are currently issued at original maturities of 2, 3, 5, 7, 10, 20, and 30 years. Treasury Bills and Floating Rate Notes are excluded. Volume is the average weekly dollar volume in par value (in millions of dollars) over the six-month period, from Jan. 1, 2023, to June 30, 2023.^b Number of Venues is the number of different trading venues in each category and the number of distinct MPIDs for bilateral transactions.^c Volume Share (%) is the measure of the dollar volume as a percent of total dollar volume.^d The volumes of ATSS and non-ATS interdealer brokers are broken out by Customer trades, Dealer trades, and PTF trades within each group.^e Data is based on the regulatory version of TRACE for U.S. Treasury Securities from Jan. 1, 2023, to June 30, 2023. Bilateral trades are a catchall classification that may include trades conducted via bilateral negotiation, as well as trades conducted electronically via platforms not registered with FINRA as an ATS.</p>			

^a This analysis is necessarily limited to transactions reported to TRACE, which may not be all transactions in U.S. Treasury securities. Transactions that take place on non-FINRA member ATSS or between two non-FINRA members are not reported to TRACE. Entities in the ATS TRACE category encompass the IDBs described in the preamble of this release. By contrast, the non-ATS IDB category in TRACE encompasses the voice-based or other non-anonymous methods of bringing together buyers and sellers. PTFs that are FINRA members are included as dealers while PTFs refer to PTFs that are not FINRA members. See Proposing Release note 43 and referencing text.

^b FINRA reports volume as par volume, where par volume is the volume measured by the face value of the bond, in dollars. See relevant weekly volume files, available at <https://www.finra.org/filing-reporting/trace/data/trace-treasury-aggregates>.

^c Dealers are counted using the number of distinct MPIDs.

^d Total dollar volume (in par value) is calculated as the sum of dollar volume for ATSS, non-ATS interdealer brokers, bilateral dealer-to-dealer transactions, and bilateral dealer-to-customer transactions.

^e We identify ATS trades and non-ATS interdealer broker trades using MPID. The regulatory version of TRACE for U.S. Treasury securities includes an identifier for customer and interdealer trades. Furthermore, we use MPID for non-FINRA member subscriber counterparties in the regulatory version of TRACE for U.S. Treasury securities to identify PTF trades on ATSS.

Table 2: Off-the-Run U.S. Treasury Securities Trading Volume

Off-the-Run U.S. Treasury Securities Trading Volume			
	Num. of Venues	Average Weekly Volume (\$M)	Volume Share (%)
<u>ATSS</u>	<u>13</u>	<u>126,489</u>	<u>18.0</u>
Customer trades	9	10,713	1.5
Dealer trades	13	107,304	15.2
PTF trades	5	8,472	1.2
<u>Non-ATS Interdealer Brokers</u>	<u>24</u>	<u>34,796</u>	<u>4.9</u>
Customer trades	19	7,967	1.1
Dealer trades	22	26,829	3.8
<u>Bilateral dealer-to-dealer trades</u>	<u>568</u>	<u>85,178</u>	<u>12.1</u>
<u>Bilateral dealer-to-customer trades</u>	<u>732</u>	<u>458,070</u>	<u>65.0</u>
Total	-	<u>704,533</u>	<u>100.0</u>
<p>This table reports trading volume and volume share for ATSS,^a non-ATS interdealer brokers, bilateral dealer-to-dealer transactions, bilateral dealer-to-customer, and bilateral dealer-to-PTF transactions for off-the-run U.S. Treasury Securities. Off-the-run or “seasoned” U.S. Treasury Securities include TIPS, STRIPS, and nominal coupon securities issues that preceded the current on-the-run nominal coupon securities. Number of Venues is the number of different trading venues in each category and the number of distinct MPIDs for bilateral transactions. Volume is the average weekly dollar volume in par value (in millions of dollars) over the six-month period, from Jan. 1, 2023, to June 30, 2023. Volume Share (%) is the measure of the dollar volume as a percent of the total dollar volume. The volumes of ATSS and non-ATS interdealer brokers are broken out by Customer trades, Dealer trades, and PTF trades within each group.^b Data is based on the regulatory version of TRACE for U.S. Treasury Securities from Jan. 1, 2023, to June 30, 2023. Bilateral trades are a catchall classification that may include trades conducted via bilateral negotiation, as well as trades conducted electronically via platforms not registered with FINRA as an ATS.</p>			

^a The analysis based on TRACE is necessarily limited to transactions reported to TRACE, which may not be all transactions in government securities. Transactions that take place on non-FINRA member ATSS or between two non-FINRA members are not reported to TRACE. The analysis based on TRACE is necessarily limited to transactions reported to TRACE, which may not be all transactions in government securities. Transactions that take place on non-FINRA member ATSS or between two non-FINRA members are not reported to TRACE. Entities in the ATS TRACE category encompass the IDBs described in the preamble of this release. By contrast, the non-ATS IDB category in TRACE encompasses the voice-based or other non-anonymous methods of bringing together buyers and sellers. PTFs that are FINRA members are included as dealers while PTFs refer to PTFs that are not FINRA members. See Proposing Release note 43 and referencing text.

^b We identify ATS trades and non-ATS interdealer broker trades using MPID in the regulatory version of TRACE for U.S. Treasury securities. The regulatory version of TRACE for U.S. Treasury securities includes an identifier for customer and interdealer trades. Furthermore, we use MPID for non-FINRA member subscriber counterparties in the regulatory version of TRACE for U.S. Treasury Securities to identify PTF trades on ATSS.

ii. Dealer-to-Customer

Dealer-to-customer trading generally involves “off-the-run” issues more often than the interdealer market and typically is conducted via voice or electronically (*i.e.*, electronic “request for quote” systems referred to in Tables 1 and 2, *supra* as non-ATS IDBs).⁶⁴⁶ Trading in the dealer-to-customer cash market is generally – and has historically been – conducted through bilateral transactions. Customers have not traditionally traded directly with other end users.⁶⁴⁷ Rather, non-dealers primarily trade with dealers, and dealers use the interdealer market as a source of orders and trading interest to help facilitate their trading with customers in the dealer-to-customer market. Generally, trades in the dealer-to-customer market are not centrally cleared.⁶⁴⁸

In cash U.S. Treasury security transactions that are bilaterally cleared, the process generally begins with participants initiating the trade by an electronic or voice trading platform, and both parties booking the details of the trade in their internal systems and confirming the details of the trade with one another. Once the details are confirmed, each party then sends messages to its clearing or settlement agents to initiate the clearing process. Different types of institutions use different clearing and settlement agents, with buy-side firms typically using custodial banks, dealers using clearing banks, and hedge funds and PTFs using prime brokers.

b. U.S. Treasury Repo Market

Depending on clearing and settlement practices, the U.S. Treasury repo market consists of four main components: (1) non-centrally cleared, settled bilaterally, (2) centrally cleared, settled bilaterally, (3) non-centrally cleared, settled on a triparty platform, and (4) centrally cleared, settled

⁶⁴⁶ G-30 Report, *supra* note 5, at 1; TMPG White Paper, *supra* note 13, at 1-2.

⁶⁴⁷ See Exchange Act Release No. 90019 (Sept. 28, 2020), 85 FR 87106, 87108 (Dec. 30, 2020).

⁶⁴⁸ G-30 Report, *supra* note 5, at 1; 2021 IAWG Report, *supra* note 4, at 3; TMPG White Paper, *supra* note 13, at 6.

on a triparty platform. The Office of Financial Research has collected transaction level data for centrally cleared repo transactions since October 2019, and the New York Fed collects data on triparty repo transactions through its supervisory role. However, as discussed in part II.A.2.a *supra*, the lack of reporting of non-centrally cleared bilateral repo makes estimating the size of this segment of the repo market difficult.

i. Non-Centrally Cleared Bilateral Repo

For non-centrally cleared bilateral U.S. Treasury repos, the parties agree to the terms and settle the trades between themselves, without involving a CCP or other third-party. As mentioned above, FICC's rules require its direct participants to submit for central clearing all eligible trades with other direct participants. Therefore, non-centrally cleared bilateral U.S. Treasury repos may involve at least one party that is not a FICC direct participant (*e.g.*, a hedge fund or PTF); alternatively, or additionally, such repos may also involve a transaction type that FICC does not accept for clearing.

In January of 2022, the Federal Reserve Bank of New York updated its primary dealer statistics to capture the segments of the repo market used by primary dealers. On average during the first three quarters of 2022, the non-centrally cleared bilateral market made up \$1.19 trillion of primary dealer reverse repo (60% of the total) and \$0.94 trillion of primary dealer repo (37% of the total).⁶⁴⁹ At more than \$2 trillion in total exposure, this would make non-centrally cleared bilateral repo the largest segment of the repo market in gross exposure by primary dealers.

The Office of Financial Research (OFR) conducted a pilot collection of data on non-centrally cleared bilateral repurchase agreement trades spanning nine dealers over three reporting

⁶⁴⁹ See Hempel et al. (2022), *supra* note 563.

dates in June 2022.⁶⁵⁰ Using that pilot data collection, the OFR finds that with regard to rates, counterparty types, and collateral, pilot participants' activity in the non-centrally cleared bilateral repo segment roughly mirrors their activity in the centrally cleared bilateral segment.⁶⁵¹ However, as discussed in part IV.B.5 *infra*, haircuts in this segment differ from those in the centrally cleared segments.⁶⁵²

ii. Centrally Cleared Bilateral Repo

For centrally cleared bilateral U.S. Treasury repos, for parties that are FICC direct participants, each party submits agreed-upon trade details to FICC for central clearing, and those trades are settled delivery versus payment using the members' clearing banks and/or Fedwire Securities Service. Market participants that are not direct participants of FICC may access central clearing through a customer model, such as the Sponsored Service or the Prime Broker/Correspondent clearing models.⁶⁵³ Although a U.S. Treasury repo transaction generally encompasses both the start leg and the end leg of a U.S. Treasury repo, currently the only U.S. Treasury securities CCA does not provide central clearing for the start leg of certain transactions.⁶⁵⁴ Central clearing of U.S. Treasury repo is further discussed below.

Data on the extent of central clearing in the U.S. Treasury securities market is limited. As discussed previously, the Commission believes that approximately half of bilateral repo trades are centrally cleared.⁶⁵⁵

⁶⁵⁰ The OFR has a proposed rulemaking that mandates the collection of daily transaction level data from certain financial companies on their non-centrally cleared bilateral repurchase agreement trades. *See supra* note 564.

⁶⁵¹ *See* Hempel et al. (2023), *supra* note 564, at 1.

⁶⁵² *Id.* at 3.

⁶⁵³ *See* Proposing Release, *supra* note 14, 87 FR at 64616.

⁶⁵⁴ FICC Rule 11, section 2, *supra* note 19.

⁶⁵⁵ *See* part IV.B.3.b.i, *supra*. *See also* note 75, *supra*.

iii. Non-Centrally Cleared Repo Settled on a Triparty Platform

For non-centrally cleared triparty U.S. Treasury repos, repo buyers (cash lenders (*e.g.*, money market funds)) provide financing to repo sellers (cash borrowers (*e.g.*, dealers)). The parties agree to the terms of a trade and arrange for a clearing bank to facilitate settlement. Like non-centrally cleared bilateral repos, at least one party to the transaction is not a FICC member. While the clearing bank provides a triparty platform to help facilitate the movement of cash and securities among accounts of counterparties to the transaction, it does not itself become a counterparty to the transactions and does not guarantee either counterparty's performance of its obligations. Collateral posted to the triparty platform generally cannot be repledged outside the platform, thereby protecting against settlement fails.⁶⁵⁶

iv. Centrally Cleared Repo Settled on a Triparty Platform

For centrally cleared U.S. Treasury triparty repos, the parties are FICC members that submit agreed-upon trade details to FICC for central clearing through FICC's General Collateral Finance ("GCF") Repo Service. Unlike centrally cleared bilateral repos, these triparty repos are settled on the clearing bank's triparty platform. Like centrally cleared bilateral repos, centrally cleared triparty repos are novated to FICC, and FICC acts as a CCP for these transactions, including by collecting margin pursuant to its margin methodology for such transactions. Until recently, centrally cleared triparty repos were only conducted through the GCF Repo Service between two direct members of FICC. However, in September 2021, FICC introduced its Sponsored General Collateral Service ("Sponsored GC Service"), which enables centrally cleared

⁶⁵⁶ See generally Reference Guide to U.S. Repo and Securities Lending Markets (Nov. 9, 2015), available at https://www.financialresearch.gov/working-papers/files/OFRwp-2015-17_Reference-Guide-to-U.S.-Repo-and-Securities-Lending-Markets.pdf.

triparty repos between a sponsored member and its sponsoring member.⁶⁵⁷ The Sponsored GC Service accepts general collateral in a number of generic CUSIPs, and though U.S. Treasury securities are among the general collateral types acceptable in the Sponsored GC Service, other types of collateral including agency and mortgage backed securities are acceptable for use as collateral as well.⁶⁵⁸ Each type of eligible collateral for the Sponsored GC Service is assigned its own generic CUSIP number, and security types are not mixed.⁶⁵⁹

v. Inter-Affiliate Repo

Current FICC rules require the submission of transactions of a netting member's "Covered Affiliate" with another FICC netting member where a Covered Affiliate is defined as an affiliate of a netting member that: (1) is not itself a netting member; (2) is not a foreign person; and (3) is a broker-dealer, bank, trust company, and/or FCM, if that transaction is with another netting member or a Covered Affiliate of another netting member.⁶⁶⁰ FICC rules do not require the submission of transactions between (1) a netting member and an affiliate or (2) between a netting member's affiliates.

The Commission understands that inter-affiliate repo transactions represent an important tool to transfer liquidity and risk within an affiliated group. These transactions may serve different purposes, including, but not limited to, providing U.S. Treasury securities for delivery when an affiliate has taken a long or short position in U.S. Treasury securities as a hedge against other

⁶⁵⁷ Exchange Act Release No. 92808 (Aug. 30, 2021), 86 FR 49580 (Sept. 3, 2021). Currently, the Bank of New York Mellon operates the triparty platform that facilitates trades conducted via the GCF Repo Service and Sponsored GC Service.

⁶⁵⁸ See generally DTCC Sponsored General Collateral Service ("DTCC SGCS"), available at <https://www.dtcc.com/-/media/Files/Downloads/Clearing-Services/FICC/GOV/SponsoredGC-FS-INTL.pdf> (last visited Dec. 11, 2023).

⁶⁵⁹ *Id.*

⁶⁶⁰ GSD Rule 11, Section 3 (along with Rule 1 for the definition of a Covered Affiliate), *supra* note 19.

exposures, allowing the movement of U.S. Treasury securities to allow them to be posted as margin on an affiliate's transaction, ensuring that U.S. Treasury securities can serve as a liquidity buffer for an affiliated bank,⁶⁶¹ or to meet liquidity composition targets. To get the U.S. Treasury securities to the appropriate entity with an affiliated group, the affiliate often enters into repos or reverse repos with a direct participant of a U.S. Treasury securities CCA.

Using assets and liabilities data reported by the five largest U.S. broker-dealers in their 2022 annual audited financial statements, the Commission observed that the value of repo and reverse repo from inter-affiliate transactions ranges from 25-75% of total repo and reverse repo reported at the end of year.

4. Central Clearing in the U.S. Treasury Securities Market

Currently, FICC is the sole provider of clearance and settlement services for U.S. Treasury securities.⁶⁶² On July 18, 2012, FSOC designated the FICC as a systemically important financial market utility under Title VIII of the U.S. Dodd-Frank Act. FSOC assigned this designation on the basis that a failure or a disruption to FICC could increase the risk of significant liquidity problems spreading among financial institutions or markets and thereby threaten the stability of the financial system in the United States.

Should a trade be centrally cleared, the CCP receives a notice of the executed trade from both parties, and after comparison (*i.e.*, matching of the trade details), the CCP guarantees and novates the contract, where novation refers to the process by which the CCP becomes the counterparty to both the buyer and seller in the original trade. Once the trading day ends and all

⁶⁶¹ A liquidity buffer generally refers to liquid assets that a banking organization manages to enable it to meet expected and unexpected cash flows and collateral needs without adversely affecting the banking organization's daily operations. *See generally* FRB, FDIC, & OCC, *Q&As on Statement Regarding the Use of Capital and Liquidity Buffers* (Mar. 17, 2020), available at <https://www.fdic.gov/news/financial-institution-letters/2020/fil20020a.pdf>.

⁶⁶² *See* part I, *supra*.

trades have been reported to the CCP (*i.e.*, end of T+0), the CCP determines its net obligations to each CCP participant for each security and communicates the resulting settlement obligations to the counterparties. The participants then have the obligation to settle their portion of the trade on T+1. Once this information is communicated, the participants send instructions to their settlement agents. In contrast to the bilateral case, central clearing reduces the credit risk that both parties are exposed to throughout the trade. While at execution both CCP members hold the usual counterparty credit risk to one another, this risk is transformed, generally within minutes of trade execution, when the trade details are sent to the CCP and the CCP guarantees and novates the trade. Consequently, both parties to the trade now hold centrally cleared credit risk, and the CCP has counterparty risk to both members.

Direct membership in FICC typically consists of banks and registered dealers, who must meet specified membership criteria.⁶⁶³ In other markets such as U.S. equity markets, not all active participants are direct members of the clearing agency. For this reason, it is likely that under the requirement to clear eligible secondary market transactions, some market participants will access clearing indirectly. At FICC, the indirect clearing models are its Sponsored Program and a prime broker/correspondent clearing program.⁶⁶⁴ As of August 14, 2023, FICC has 208 direct members.⁶⁶⁵

⁶⁶³ The Commission believes that not all market participants likely would satisfy a covered clearing agency's stringent membership criteria. *See* 17 CFR 17ad-22(e)(18); FICC Rule 2A, *supra* note 19. Even among those that do, legal operational or other considerations may preclude many market participants from becoming direct members of a CCP that clears and settles government securities transactions.

⁶⁶⁴ *See, e.g.*, FICC Rules, 8, 18, 3A (providing for prime brokerage and correspondent clearing, as well as sponsored membership), *supra* note 19.

⁶⁶⁵ *See* FICC Member Directories, available at <https://www.dtcc.com/client-center/ficc-gov-directories> (last visited Dec. 12, 2023) (This includes all members who make use of Netting, Repurchase Netting, and/or GCF services.).

Centrally cleared institutional triparty (“CCIT”) membership is a limited direct membership for entities who buy repo using FICC’s GCF Repo Service that settles using triparty settlement.⁶⁶⁶ In 2017, FICC developed the CCIT Service to allow repo cash providers to access central clearing as limited-purpose members without the sponsorship or intermediation of a direct participant.⁶⁶⁷ These entities pledge to FICC the purchased securities under their repos in order to secure their obligation to perform under the transaction. As of July 27, 2023, there were 7 CCIT members, all of which were affiliated with a single investment firm.⁶⁶⁸

FICC interacts solely with the Sponsoring Member/direct participant as agent for purposes of the Sponsoring Member’s clients/Sponsored Members’ obligations to and from FICC. Sponsoring Members also guarantee to FICC the payment and performance obligations of their Sponsored Members.⁶⁶⁹ Sponsoring Members can be either bank direct participants of FICC that meet certain capital and other requirements or any other FICC direct participant that meets what FICC determines to be the appropriate financial resource requirements; in practice, Sponsoring Members include both banks and broker-dealers.⁶⁷⁰ Sponsored Members have to be “qualified institutional buyers” as defined by Rule 144A under the Securities Act of 1933, as amended, or

⁶⁶⁶ DTCC, CCIT Service, *available at* <https://www.dtcc.com/clearing-services/ficc-gov/centrally-cleared-institutional-triparty>.

⁶⁶⁷ The Commission has not yet approved registered investment companies to participate in CCIT. *See Order Granting Approval of Proposed Rule Change to Establish the Centrally Cleared Institutional Triparty Service and Make Other Changes*, Exchange Act Release No. 80574, File No. SR-FICC-2017-005, 82 FR 21439, 21440 n.11 (May 2, 2017).

⁶⁶⁸ DTCC, FICC-Gov Member Directory (July 27, 2023), *available at* <https://www.dtcc.com/client-center/-/media/Files/Downloads/client-center/FICC/FICC-GSD-Member-Directory-CCIT.xlsx>.

⁶⁶⁹ *See* Exchange Act Release No. 51896 (June 21, 2005), 70 FR 36981 (June 27, 2005); *see also* FICC Rule 3A, *supra* note 19. For general information and statistics regarding the Sponsored Service, *see* DTCC, Sponsored Service, *available at* <https://www.dtcc.com/clearing-services/ficc-gov/sponsored-membership>, as well as part IV.B.7.d.i *infra*. The Sponsored Service also allows the submission of cash transactions; however, at this time, the service is generally used only for U.S. Treasury repo transactions.

⁶⁷⁰ *See* FICC Rule 3A, section 2(a) and (b), *supra* note 19; DTCC, *FICC GSD Member Directory* (Oct. 31, 2023), *available at* <https://www.dtcc.com/-/media/Files/Downloads/client-center/FICC/Mem-GOV-by-name.xlsx> (identifying Sponsoring Members as those with Omnibus accounts).

otherwise meet the financial standards necessary to be a “qualified institutional buyer,” and currently, Sponsored Members generally consist of hedge funds, money market funds, other asset managers, and smaller banks.⁶⁷¹

The Sponsored Service allows eligible direct participants (Sponsoring Members) to (i) sponsor their clients into a limited form of FICC membership (Sponsored Members) and then (ii) submit certain eligible client securities transactions for central clearing. The requirement to clear eligible secondary market transactions could affect Sponsored Members. FICC interacts solely with the Sponsoring Member/direct participant as agent. Sponsoring Members guarantee to FICC the payment and performance obligations of its Sponsored Members.⁶⁷² Following FICC’s expansion in 2021 of its Sponsored Service to allow Sponsored Members to clear triparty repos through the program,⁶⁷³ there are now approximately 350 Sponsoring Members and approximately 2,200 Sponsored Members⁶⁷⁴ with access to central clearing. During the 12-month period ending on August 15, 2023, the total dollar value of Sponsored Members’ daily repo and reverse repo activity ranged from a high of \$771.7 billion on June 30, 2023, to a low of \$265.8 billion on September 14, 2022.⁶⁷⁵

⁶⁷¹ See FICC Rule 3A, section 3(a), *supra* note 19; FICC Sponsored Membership Listing, *available at* <https://www.dtcc.com/client-center/ficc-gov-directories>.

⁶⁷² See FICC’s GSD Rule 3A, *supra* note 663. Sponsored Members have to be Securities Act Rule 144A “qualified institutional buyers,” or otherwise meet the financial standards necessary to be a “qualified institutional buyer.” See *id.*, Rule 3A, section 3(a).

⁶⁷³ See Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change to Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook and Make Other Changes, Exchange Act Release No. 85470 (Mar. 29, 2019).

⁶⁷⁴ In its 2022 annual report, DTCC reported that FICC’s sponsored service expanded during the year to more than 35 sponsoring members. DTCC 2022 Annual Report, *supra* note 737, at 29. See also *supra* note 668.

⁶⁷⁵ This information was available from DTCC on the 1 year version of the FICC Sponsored Activity chart as of Aug. 15, 2023. DTCC, Sponsored Membership (last updated Dec. 1, 2023), *available at* <https://www.dtcc.com/charts/membership>.

Among the various types of financial firms that are Sponsored Members are (i) over 1,400 funds, including a number of hedge funds, many money market funds, other mutual funds, and a smaller number of exchange-traded funds (“ETFs”);⁶⁷⁶ (ii) banks, including a small number of national, regional Federal Home Loan Banks, and international banks; and (iii) other asset managers including a few insurance companies.⁶⁷⁷

From a direct participant’s perspective, clearing a U.S. Treasury securities transaction at FICC between that participant and its non-participant counterparty (*i.e.*, a dealer-to-client trade) need not result in a separate collection of margin for each transaction. Transactions between direct participants are novated by FICC, and, by virtue of multilateral netting, all of a member’s positions are netted into a single payment obligation—either to or from the CCP. In contrast, in a dealer-to-client trade, there is no transaction between two direct participants that FICC membership rules would require to be novated to the CCP, and as a result, FICC does not provide any guaranty of settlement or otherwise risk manage this trade.⁶⁷⁸ In other words, as one recent publication explained, “if a dealer were to buy a security from its own customer and submit this transaction to FICC, there would be no effect on the dealer’s net position at, obligations to, or guarantees from FICC.”⁶⁷⁹ Indeed, except for its sponsored program, because FICC nets all trades at a dealer before

⁶⁷⁶ For various persons, direct participation in FICC may not be an alternative to the Sponsored Membership program. For example, “[a] subset of market participants, such as certain money market funds, face legal obstacles to joining FICC because they are prohibited from mutualizing losses from other clearing members in the way that FICC rules currently require.” Marta Chaffee and Sam-Schulhofer-Wohl, *infra* note 678, at 2.

⁶⁷⁷ FICC Membership Listing, *supra* note 670.

⁶⁷⁸ See Marta Chaffee and Sam-Schulhofer-Wohl, *Is a Treasury Clearing Mandate the Path to Increased Central Clearing?*, CHICAGO FED INSIGHTS, [https://www.chicagofed.org/publications/blogs/chicago-fed-insights/2021/treasury-clearing-mandate-\(June-23,-2021\)](https://www.chicagofed.org/publications/blogs/chicago-fed-insights/2021/treasury-clearing-mandate-(June-23,-2021)) (explaining that this conclusion follows from that fact that “FICC nets members’ trades for their own accounts against trades by the members’ customers, so the dealer’s and customer’s sides of the trade would cancel out in the netting process.”).

⁶⁷⁹ *Id.*

calculating margin, as at present, customer trades with their own dealers generate no margin requirement and are not collateralized at the CCP.

Sponsored Members participating in FICC’s Sponsored Service are indirect members of FICC, and upon novation of their U.S. Treasury transactions, FICC becomes obligated to such Sponsored Members.⁶⁸⁰ FICC requires that its Sponsoring Members provide margin on a gross basis for its Sponsored Member positions.⁶⁸¹ In FICC’s correspondent clearing and prime brokerage clearing models, the client of the netting member does not have a legal relationship with FICC.⁶⁸² FICC only has CCP obligation to the correspondent clearer or prime broker itself, as applicable, who is a FICC member.

Certain aspects of FICC’s Sponsored Service are worth noting, as they may have an effect on some market participants’ willingness to participate in the service. For example, once a trade is novated, FICC makes delivery of cash or securities to the Sponsoring Member as agent for the Sponsored Member.⁶⁸³ Therefore, market participants may consider the ability of their Sponsoring Member to make delivery to them in situations in which the Sponsoring Member is in default, when determining whether to use the Sponsored Service. In addition, if a Sponsoring Member defaults, FICC continues to guarantee any novated sponsored trades and may determine whether to close out a sponsored trade and/or to permit the Sponsored Member to settle the trade.⁶⁸⁴ This may

⁶⁸⁰ FICC-GSD Rule 3A sections 3 (membership) and 7 (novation), *supra* note 19.

⁶⁸¹ FICC Rule 3A, section 10(c), *supra* note 19. *See also* The Depository Trust and Clearing Corporation (DTCC), *Making the U.S. Treasury Market Safer for All Participants: How FICC’s Open Access Model Promotes Central Clearing* (white paper, Oct. 2021), available at <https://www.dtcc.com/-/media/Files/Downloads/WhitePapers/Making-the-Treasury-Market-Safer-for-all-Participants.pdf> (“DTCC October 2021 White Paper”) at 5-6.

⁶⁸² FICC Rule 8, *supra* note 19. *See* DTCC October 2021 White Paper, *supra* note 681, at 5, which reports that \$80 billion plus of activity are observed clearing and settling daily through FICC’s correspondent clearing and prime broker clearing models.

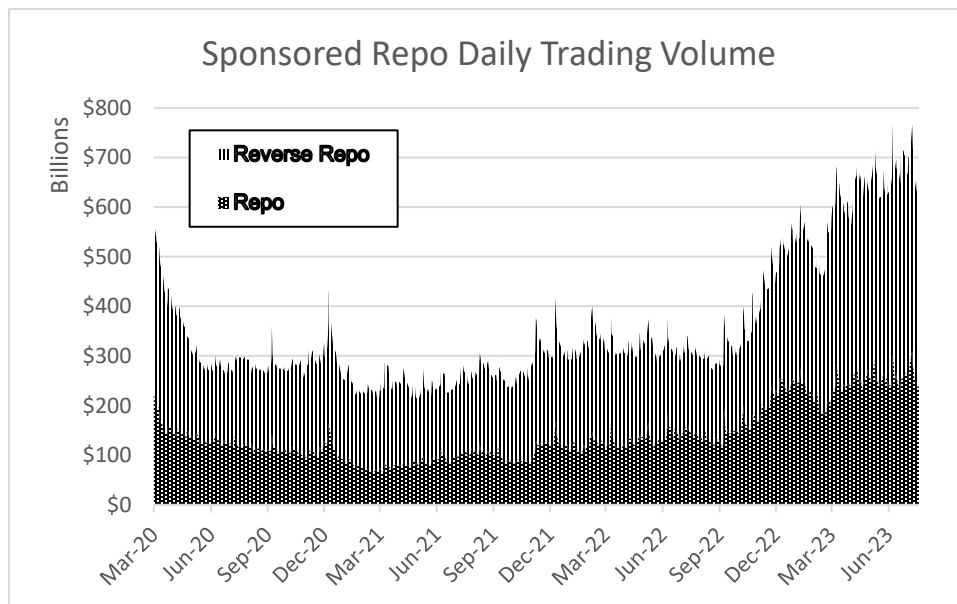
⁶⁸³ FICC Rule 3A, sections 8 and 9, *supra* note 19.

⁶⁸⁴ FICC Rule 3, section 14(c), *supra* note 19.

lead a potential sponsored member to decline to enter a sponsoring relationship unless it was willing to trade bilaterally with those sponsoring firms. The Commission understands that some Sponsoring Members also may limit which market participant's trades they are willing to sponsor based on firm type. Sponsored triparty repo is a relatively recent addition.⁶⁸⁵ Volumes of sponsored repo fluctuate, but they appear to be substantial as Figure 6 shows.

In addition, the Commission understands that it is common practice for sponsoring members to only offer clearing services for transactions in which the sponsor is the counterparty to the sponsored member. This bundling of execution and central clearing sponsor services means that should a non-FICC member wish to centrally clear a U.S. Treasury transaction, it is limited in the counterparties with which it can trade to those FICC direct members with which it has an existing sponsoring member relationship.

Figure 6: Sponsored Repo Daily Trading Volume^a



^a DTCC, *Sponsored Membership* (last updated Dec. 4, 2023), available at <https://www.dtcc.com/charts/membership>

⁶⁸⁵ See generally DTCC SGCS, *supra* note 658.

In order for a CCP to perform as the guarantor of trades that have been novated to it, the CCP must have resources available to absorb the costs of clearing member non-performance. FICC is required by Commission rule to have policies and procedures reasonably designed to maintain financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the largest aggregate credit exposure in extreme but plausible market conditions.⁶⁸⁶ A CCP's plan to deal with a clearing member default is referred to as its default waterfall. The default waterfall provides an identification of resources that the CCP will use in attempting to recoup losses from clearing member defaults. The FICC waterfall comprises the defaulting clearing member's contribution (*i.e.*, margin, as well as any other resources the member has on deposit such as excess margin, the proceeds from liquidating the member's portfolio, and any amounts available from cross-guaranty agreements), the corporate contribution to the clearing fund, followed by non-defaulting clearing members' margin.⁶⁸⁷

In addition, with respect to liquidity risk, the Commission's rules require FICC to have policies and procedures reasonably designed to meet a "cover-1" standard and hold qualifying liquid resources sufficient to complete its settlement obligations in the event of the default of the largest member and its affiliates.⁶⁸⁸ For example, if a clearing member has a net long position in a

⁶⁸⁶ 17 CFR 240.17ad-22(e)(4)(iii).

⁶⁸⁷ FICC Rule 4, sections 6 and 7, *supra* note 19.

⁶⁸⁸ Specifically, the Commission's rules require FICC to have policies and procedures reasonably designed to maintain sufficient 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, and to hold qualifying liquid resources sufficient to meet that requirement. *See* 17 CFR 240.17ad-22(e)(7)(i) and (ii).

security that has not yet settled, the CCP must have the cash available to complete the purchase. The securities can be subsequently liquidated and any losses that may result would be covered by the resources in the default waterfall. The first liquidity source that FICC would use in the event of a member default is the cash portion of the clearing fund.⁶⁸⁹ Second, FICC can pledge securities in the clearing fund as a source of cash, including securities that would have otherwise been delivered to the defaulting member.⁶⁹⁰ Should additional liquid resources be required FICC could make use of the CCLF.⁶⁹¹

The CCLF is a rules-based arrangement in which FICC members are obligated to participate as a condition of their membership. Should FICC declare a CCLF event, each member would be obligated to enter into repurchase agreements with FICC up to a member-specific limit.⁶⁹² The CCLF is not prefunded, and it is separate from FICC's margin requirements. Each FICC member is required, by FICC's rules, to attest that its CCLF requirement has been incorporated into its liquidity planning and related operational plans at least annually and in the event of any changes to such Member's CCLF requirement.⁶⁹³ Thus, the members are obligated to have such resources lined up, which can be costly.⁶⁹⁴

⁶⁸⁹ FICC Rule 4, sections 5 and 6, *supra* note 19.

⁶⁹⁰ *Id.*

⁶⁹¹ FICC Rule 22A, section 2a, *supra* note 19.

⁶⁹² These repurchase agreements may continue for up to 30 days. See FICC Rule 22A, section 2a(a)(L), *supra* note 19.

⁶⁹³ FICC Rule 22A, section 2a(d), *supra* note 19.

⁶⁹⁴ See Independent Dealer & Trader Association, *White Paper on the Repo Market Affecting U.S. Treasury and Agency MBS* 8 (Dec. 6, 2019), available at <https://static1.squarespace.com/static/5ad0d0abda02bc52f0ad4922/t/5dea7fb6af08dd44e68f48cc/1575649207172/IDTA+-+White+Paper+%2812.6.19%29-c2.pdf> ("In light of the fact that a significant component of a firm's CCLF obligation is based on its overnight liquidity exposures at FICC, middle-market dealers immediately took to reducing their reliance on overnight liquidity. Some middle-market dealers reduced the size of their portfolio and extended liquidity terms in place of overnight funding, adding to both financing and opportunity costs. Others have incorporated liquidity plans for which commitment and administration fees materially added to the cost of doing business.").

The CCLF provides a mechanism for FICC to enter into repurchase transactions based on the clearing activity of the defaulted participant. Specifically, in the event that FICC declares a CCLF event, FICC’s members would be required to hold and fund their deliveries to the defaulting member, up to a predetermined capped dollar amount, by entering into repurchase transactions with FICC until FICC completes the associated closeout.⁶⁹⁵ The aggregate size of the CCLF is the historical cover-1 liquidity requirement (*i.e.*, the largest liquidity need generated by an Affiliated Family during the preceding six-month period) plus a liquidity buffer (*i.e.*, the greater of 20 percent of the historical cover-1 liquidity requirement or \$15 billion).⁶⁹⁶

The first \$15 billion of the total amount of the CCLF is shared, on a scaled basis, across all members. Any remaining amount is allocated to members who present liquidity needs greater than \$15 billion, using a liquidity tier structure based on frequency of liquidity created across liquidity tiers in \$5 billion increments.⁶⁹⁷ The size of the CCLF and each member’s share is reset every 6 months or as appropriate.⁶⁹⁸ Figure 7 provides data on the aggregate amount of the CCLF from 2018 quarter 4 through 2023 quarter 1. The aggregate size of the CCLF was over \$76 billion in 2023 quarter 1.

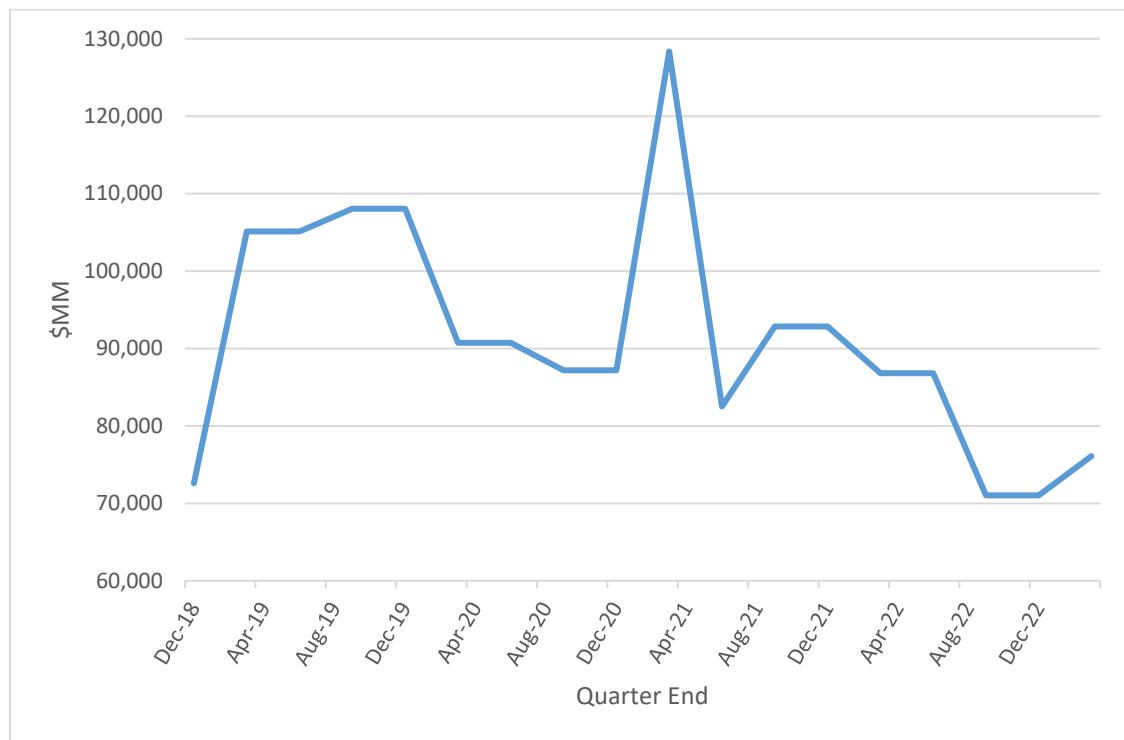
⁶⁹⁵ See generally FICC Rule 22A, section 2a(b), *supra* note 19. For details on the process, see Order Approving a Proposed Rule Change to Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook, Exchange Act Release No. 82090 (Nov. 15, 2017), 82 FR 52457 (Nov. 21, 2017).

⁶⁹⁶ FICC Rule 1 (definitions of Aggregate Total Amount and Liquidity Buffer) and 22A, section 2, *supra* note 19.

⁶⁹⁷ FICC Rule 22A, section 2a(b)(iii), (iv), and (v), *supra* note 663. See also Exchange Act Release No. 82090, *supra* note 695, 82 FR at 55429-30.

⁶⁹⁸ FICC Rule 22A, section 2a(b)(ii), (iii), (iv), and (v), *supra* note 19.

Figure 7: Aggregate CCLF (\$MM) at Quarter End^a



^a Calculated using data from CPMI-IOSCO Quantitative Disclosure Results [quarterly] (for FICC), Disclosure Reference 7.1.6, available at <https://www.dtcc.com/legal/policy-and-compliance>.

5. Margin Practices in U.S. Treasury Secondary Markets

As described above, posting of margin is one way to manage the risk of settlement in cash trades. Indeed, for trades that are centrally cleared, the CCP collects margin on an intraday basis, typically twice per day.⁶⁹⁹ Varying bespoke arrangements appear to characterize current margining practices in the bilateral, non-centrally cleared cash market.⁷⁰⁰ A recent publication stated that competitive pressures in the bilaterally settled market for repo transactions has exerted

⁶⁹⁹ TMPG White Paper, *supra* note 13, at 3.

⁷⁰⁰ *Id.* at 3. Non-centrally cleared cash trades are negotiated and settled bilaterally, and the Commission has little direct insight into the arrangements market participants use to manage their counterparty exposure. The TMPG observes in the White Paper that non-centrally cleared trades are “...not margined in a uniform or transparent manner, thereby creating uncertainty about counterparties’ exposure to credit and market risk.” *Id.*

downward pressure on haircuts, sometimes to zero.⁷⁰¹ The Commission understands that most non-centrally cleared bilateral repo trades go unmargined.⁷⁰² For non-centrally cleared repo including that which is settled using the triparty platform, haircuts serve as a counterparty credit risk mitigant. The median haircut on U.S. Treasury collateral for non-centrally cleared bilateral repo that is settled on the triparty platform has been 2% since at least 2010.⁷⁰³

In a study of non-centrally cleared bilateral repo trade data collected in its June 2022 pilot study, the OFR reports that 74% of all volume is transacted at zero haircut.⁷⁰⁴ The report also suggests that this finding is in part due to the use of netted packages, in which a dealer will conduct both a repo and a reverse repo with the same counterparty and the same tenor but over different pieces of Treasury collateral.⁷⁰⁵ The report also provides evidence that haircuts reflect not only the riskiness of the collateral but also the relative credit risk of the counterparties. For example, haircuts on Treasury repo where dealers are selling repo to hedge fund customers are usually zero or negative, while haircuts where dealers buying repo from hedge funds are usually zero or positive.⁷⁰⁶

The reduction of haircuts, which serve as the primary counterparty credit risk mitigant in non-centrally cleared and bilaterally settled repos, could result in greater exposure to potential counterparty default risk in non-centrally cleared repos. Such arrangements (in both cash and

⁷⁰¹ G-30 Report, *supra* note 5, at 13.

⁷⁰² TMPG White Paper, *supra* note 13, at 3 (“Margining has not been a common practice for regularly settling bilaterally cleared transactions...”).

⁷⁰³ See *Tri-Party/GCF Repo*, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo/index.html#interactive/margins>.

⁷⁰⁴ See Hempel et al. (2023), *supra* note 564, at 3 and 7-9.

⁷⁰⁵ *Id.*

⁷⁰⁶ *Id.* at 7.

repo) may not take into account the value of margin in protecting against systemic events, because they are designed to be optimal for the counterparties rather than the larger financial market.

For centrally cleared cash U.S. Treasury transactions, however, FICC rules dictate that margin must be posted based on the net positions of all members with the clearing agency.⁷⁰⁷ Positions in securities with longer maturities – for example, 20+ year U.S. Treasury bonds – require more margin to be posted because they are more sensitive to interest rate changes. Required margin is also larger for short positions, and it rises with volatility in the U.S. Treasury securities market.⁷⁰⁸ For example, during the first quarter of 2020, a period which includes the U.S. Treasury securities market disruption of March 2020, total initial margin required was 9.4% higher than the previous quarter and the average total variation margin paid was 72% higher.⁷⁰⁹

FICC Rules set forth the various components of a member's margin requirements.⁷¹⁰ The largest component is a Value-at-Risk (VaR) charge, which is calculated both intraday and end-of-day and reflects potential price volatility of unsettled positions. FICC typically calculates VaR using ten years of historical data; for securities without the requisite amount of data, FICC instead employs a haircut approach, where the required margin is some percentage of the traded security's value. Other components of FICC's margin requirements include a liquidity adjustment charge, which is levied against members who have large, concentrated positions in particular securities

⁷⁰⁷ See Part IV.B.3.4, *supra* for a discussion of how FICC requires for margining of sponsored positions.

⁷⁰⁸ See FICC Rule 4, section 1b, *supra* note 19. FICC's margin requirements are discussed in more detail below. A key component of the margin requirement is a Value-at-Risk charge, where the calculated margin requirement is based in part on the historical volatility of the traded security. Securities that are more sensitive to interest rates should have higher VaR, all else equal.

⁷⁰⁹ See *CPMI IOSCO Quantitative Disclosure Results for 2020Q1 and 2019Q4*, items 6.1.1 and 6.6.1, available at <https://www.dtcc.com/legal/policy-and-compliance>.

⁷¹⁰ FICC Rule 4, section 1b, *supra* note 19.

that FICC determines to be difficult to liquidate, and special charges that can be levied in response to changes in aggregate market conditions (such as increases in market-wide volatility).

In the market for bilaterally cleared repo, margin typically comes in the form of haircuts. For example, if a repo buyer is providing \$100 of cash in return for \$102 of securities from the repo seller, then the haircut would be \$2. The difference between the value of the securities sold and the initial price paid, which is essentially a form of initial margin, protects the buyer by making it more costly for the seller to fail to repurchase the securities as agreed at the end of the repo, while also protecting the buyer against the risk that short-term volatility erodes the value of the purchased securities.⁷¹¹ The difference between the cash provided and the value of the securities is known colloquially as a “haircut.” Triparty repo also features overcollateralization, where the haircut is again negotiated bilaterally between the two counterparties.⁷¹² Data from the Federal Reserve Bank of New York show that a 2% haircut is the norm in the Triparty/GCF repo market, though there are occasionally some deviations from the norm.⁷¹³ Money market funds also generally require margin of 2%, which is generally the case for other investment companies as well.⁷¹⁴ Outside of money market funds and other investment companies, due to the lack of

⁷¹¹ With respect to registered investment company lenders seeking to rely on Rule 5b-3 under the 1940 Act, the value of the collateral received under a repo must be at least equal to the resale price, reduced by the transaction costs (including loss of interest) that the investment company reasonably could expect to incur if the cash borrower defaults. *See* Rule 5b-3(a); (c)(1).

⁷¹² Although triparty repo transactions are settled through a clearing bank, the terms of the transactions are bilaterally negotiated. Although haircuts vary by collateral type, the variance of haircuts is small for U.S. Treasury repo compared to other collateral types. *See* Paddrik et al., *supra* note 631.

⁷¹³ For data on the median, 10th, and 90th percentiles of overcollateralization in Triparty repo, *see Tri-Party/GCF Repo*, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo>. The median level of overcollateralization has been 2% for the entire period from May 2010 through July 2023. The 10th and 90th percentiles are also typically 2%, although the 10th percentile has occasionally fallen to as low as zero—notably, in the summer of 2011, briefly in Sept. 2012, and in the period from Sept. of 2022 through early Jan. of 2023—while the 90th percentile has occasionally spiked to as high as 5% - specifically in Jan. 2017 and again in Apr. of the same year.

⁷¹⁴ *See* Viktoria Baklanova, Isaac Kuznits, Trevor Tatum, *Primer: Money Market Funds and the Repo Market* (Feb. 18, 2021), available at <https://www.sec.gov/files/mmfs-and-the-repo-market-021721.pdf> (“MMF Primer”).

reporting requirements for bilateral repo, the Commission lacks good insight into margin practices of participants in the market for bilaterally cleared repo. Anecdotally, the Commission understands that – as with the cash market – some participants may not be required to post any margin.⁷¹⁵

While positive haircuts protect the repo buyer, the bilaterally cleared repo market generally does not feature the same level of protection for the repo seller. Indeed, one of the main benefits of the bilateral market to repo buyers is that it allows them to resell the securities purchased in the start leg of the repo. As a result, repo sellers are exposed to settlement risk and must manage that risk as they see fit. In the triparty repo market, securities purchased as part of a repo transaction remain in the custody of the clearing bank and cannot be reused by the repo buyer except as collateral in another triparty repurchase agreement, reducing settlement risk for the repo seller.

Unlike bilaterally cleared and triparty repo the counterparties to a centrally cleared repo transaction must post cash margin to the CCP twice per day, as they do with trades in the cash market. Repo sellers may be required to post more margin than repo buyers, similar to how in the bilaterally cleared market repo sellers post margin through haircuts while repo buyers do not.

6. Disruptions in the U.S. Treasury Securities Market

There have been significant disruptions in the U.S. Treasury securities market in recent years. Although different in their scope and magnitude, these events all generally involved dramatic increases in market price volatility and/or sharp decreases in available liquidity.⁷¹⁶ U.S.

⁷¹⁵ See G-30 Report, *supra* note 5, at 13 (noting that minimum margin requirements “...would stop competitive pressures from driving haircuts down (sometimes to zero), which reportedly has been the case in recent years.”).

⁷¹⁶ See 2021 IAWG Report, *supra* note 4, for further discussion of these and other disruptions. See also Remarks by Under Secretary for Domestic finance Nellie Liang at the 2022 Treasury Market Conference, *available at* <https://home.treasury.gov/news/press-releases/jy1110>. Under Secretary Liang points out that continued liquidity concerns are linked to higher volatility since the COVID-19 shock of Mar. 2020.

Treasury securities are generally not information sensitive in that their payoff is fixed in nominal terms. Moreover, there is little evidence that information on inflation risk or expectations could have driven the volatility observed in these episodes, raising the possibility that the volatility originated in a buy-sell imbalance, as opposed to fundamental factors. While a market failure could be the origin of price volatility, the forward-looking nature of markets can compound liquidity-driven price movements. The fear of being unable to exit a position can lead to a “rush to the exits,” leading to yet greater price swings. Because U.S. Treasury securities are standardized, they generally benefit from a deep, ready market for transactions. Investors count on the ability to move between cash and U.S. Treasury securities seamlessly.⁷¹⁷ This makes events that reduce liquidity in these markets especially striking and destabilizing to the overall market. Moreover, since the Proposal, regulators and others have noted the persistence of illiquidity and the mitigating effect of greater central clearing.⁷¹⁸

a. COVID-19 shock of March 2020

The market for U.S. Treasury securities experienced significant disruptions in March 2020, characterized by a spike in volume, whose origins may have been multiple but included high levels of selling by foreign banks and by hedge funds.⁷¹⁹ For example, hedge funds, one of the principal sellers of U.S Treasury futures, hedge their short futures position by establishing a long position in

⁷¹⁷ U.S. Treasury securities are often used as substitutes for cash. There is anecdotal evidence that during Mar. 2020, some market participants refused U.S. Treasury securities collateral in favor of cash.

⁷¹⁸ See Remarks by Under Secretary for Domestic Finance Nellie Liang at the 2022 Treasury Market Conference available at <https://home.treasury.gov/news/press-releases/jy1110>, Enhancing The Resilience of the U.S. Treasury Market: 2022 Staff Progress Report (Nov 10, 2022), available at <https://home.treasury.gov/system/files/136/2022-IAWG-Treasury-Report.pdf>, and Darrel Duffie, *Resilience redux in the US Treasury market*, Jackson Hole Symposium (Sept. 2, 2023), available at <https://www.kansascityfed.org/Jackson%20Hole/documents/9780/JH-2023BW.pdf>. See also Darrell Duffie, Michael Fleming, Frank Keane, Claire Nelson, Or Shachar, and Peter Van Tassel, *B.6.aa*, Internal SEC seminar (July 2023), available at <https://www.sec.gov/comments/s7-23-22/s72322-260739-614102.pdf>.

⁷¹⁹ See SEC Staff Report on U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock (Oct. 2020), available at https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf.

the cash market, creating a “cash-futures basis trade.”⁷²⁰ The cash position of this trade is often highly levered, using the repo market for financing. In March, as the U.S. Treasury securities market came under stress and as repo rates increased in some segments of the repo market, the economics of the cash-futures basis trade worsened and various funds found it necessary to unwind at least a portion of their positions. This unwinding of positions resulted in more outright sales of U.S. Treasury securities in the cash market, adding further stress through a feedback loop.⁷²¹

During this period, bid-ask spreads increased by a factor of 5, and market depth on inter-dealer brokers decreased by a factor of 10. The price of 30-year U.S. Treasury securities fell by 10% in one two-day period. Arbitrage relations appeared to break down throughout the market.⁷²² This may, as discussed above, have led to the winding down of the cash-futures basis trade, for example, adding to further stress.⁷²³ There also appeared to be large-scale selling from foreign investors, including official institutions, to address their domestic currency and liquidity needs.⁷²⁴

Duffie and Liang and Parkinson, among others, have tied these patterns to underlying U.S. Treasury securities market structure, in which intermediation capacity may be reduced relative to

⁷²⁰ See Ayelen Banegas, Phillip J. Monin, and Lubomir Petrasek, *Sizing hedge funds' Treasury market activities and holdings* (FEDS Notes Oct. 6, 2021), available at <https://www.federalreserve.gov/econres/notes/feds-notes/sizing-hedge-funds-treasury-market-activities-and-holdings-20211006.html>.

⁷²¹ See *supra* note 719, at 4. In addition, a similar dynamic was observed in the risk parity trades, where hedge funds lever up (through the repo markets) lower volatility fixed-income positions (e.g., government bonds) to create a risk-equalized portfolio across asset classes. See also *id.*

⁷²² Duffie, *supra* note 27.

⁷²³ See generally Ayelen Banegas et al., *supra* note 720; see also Daniel Barth & R. Jay Kahn, *Hedge Funds and the Treasury Cash-Futures Disconnect* (Apr. 1, 2021), available at <https://www.financialresearch.gov/working-papers/2021/04/01/hedge-funds-and-the-treasury-cash-futures-disconnect/>; Mathias S. Krutli, Phillip J. Monin, Lubomir Petrasek, & Sumudu W. Watugala, *Hedge Fund Treasury Trading and Funding Fragility: Evidence from the COVID-19 Crisis* (working paper Fin. and Econ. Disc. Series 2021-038), Fed. Res. Bd (Apr. 2021), available at <https://www.federalreserve.gov/econres/feds/files/2021038pap.pdf>.

⁷²⁴ See Colin R. Weiss, *Foreign Demand for U.S. Treasury Securities during the Pandemic* (FEDS Notes, Jan. 28, 2022), available at <https://www.federalreserve.gov/econres/notes/feds-notes/foreign-demand-for-us-treasury-securities-during-the-pandemic-20220128.htm>.

the size of the market and ultimate buyers and sellers may have difficulty locating each other. These authors discuss ways in which central clearing could have reduced these problems, mitigating the large price swings due to illiquidity in the market just when it was most needed.⁷²⁵ One view of central clearing is that it may facilitate all-to-all trading, thus helping ultimate buyers and sellers find each other.⁷²⁶ More buyers and sellers of U.S. Treasury securities could potentially act as additional sources of liquidity in a market with central clearing.

b. September 2019 repo market disruptions

The repo market experienced a substantial disruption starting September 16, 2019, when overnight repo rates began to rise, and on September 17, 2019, when the rise in repo rates accelerated dramatically. During the episode, the Secured Overnight Financing Rate (SOFR) – a measure of the average cost of overnight repo borrowing (e.g., the implied cost of borrowing by selling overnight repo) – spiked by 300 basis points to over 5% in the course of 2 days. There was also a wide dispersion around this average; some trades occurred at rates as high as 9%. On top of this, the spread between the 1st and 99th percentile rates increased substantially from its average earlier in 2019 of approximately 25 basis points to approximately 675 basis points during the disruption. The disruption spilled over into the other markets, with the Effective Federal Funds Rate (EFFR) rising above the Federal Reserve target by 5 basis points.

The disruption occurred amidst two events: first, a large withdrawal of reserves from the banking system to service corporate tax payments due September 16; and second, the settlement of U.S. Treasury securities auctions. Altogether, the tax payments led approximately \$120 billion to

⁷²⁵ Duffie, *supra* note 27; Nellie Liang & Pat Parkinson, *Enhancing Liquidity of the U.S. Treasury Market Under Stress* (Hutchins Ctr. Working Paper No. 72, 2020), available at https://www.brookings.edu/wp-content/uploads/2020/12/WP72_Liang-Parkinson.pdf (“Liang & Parkinson”).

⁷²⁶ See Duffie, *supra* note 27.

flow away from bank reserves, bringing them down to their lowest level in 5 years.⁷²⁷ Moreover, the auction settlement raised the supply of U.S. Treasury securities outstanding, which was accompanied by an increased demand for cash to fund purchases of these securities. The need for cash reserves played a role in what appears to be an unwillingness of banks to lend to one another at very high rates. Less tangibly, market expectations could have played a role; it is possible that the spike in rates could have been interpreted as a signal for a future need of cash reserves, leading banks to conserve cash regardless of what appeared to be strong economic incentives to do otherwise.

While the need for the banking system to replace reserves with cash may be part of the explanation, in a well-operating market high rates for overnight borrowing collateralized by U.S. Treasury securities (i.e., the implied cost of borrowing by selling overnight repo) would have attracted other market participants. Ultimately, as it did in March 2020, the Federal Reserve injected reserves into the system – the economic equivalent of lending to banks. The overnight repo operations totaled \$75 billion on September 17, 2019. Besides directly providing cash, this perhaps signaled the Fed’s willingness and ability to lend as needed to restore rates to levels that would occur in the absence of market frictions. In such a setting, a potential benefit of enhanced clearing for U.S. Treasury repo and cash is its ability to reduce those market frictions directly, without official sector intervention.

c. October 2014 flash rally

In March 2020 U.S. Treasury securities’ prices fell, whereas in September 2019 the rate for lending increased. Both events were associated with an increase in the cost of borrowing (i.e., the

⁷²⁷ See Sriya Anbil, Alyssa Anderson, and Zeynep Senyuz, *What Happened in Money Markets in September 2019?* (FEDS Notes, Feb. 27, 2020), available at <https://www.federalreserve.gov/econres/notes/feds-notes/what-happened-in-money-markets-in-september-2019-20200227.htm>.

implied cost of borrowing by selling overnight repo). The events of October 15, 2014, were different in form: in this instance, yields on U.S. Treasury bonds fell quickly and dramatically, leading to large increases in prices, without any clear explanation. The intraday range for the 10-year bond was 37 basis points, one of the largest on record, and far outside the typical historical distribution.⁷²⁸ October 15, 2014, featured the release of somewhat weaker-than-expected U.S. retail sales data at 8:30 a.m. ET. While the data appeared to prompt the initial decline in interest rates, the reaction was far larger than would have been expected given the modest surprise in the data. Suggestive of some connection is that the dollar amount of standing quotes in the central limit order books on cash and futures trading platforms—a measure of the quantity of liquidity that is commonly referred to as “market depth”—fell dramatically in the hour before the event window.

A sudden rise in price does not at first appear as potentially disruptive as a decline. However, it appears that levered market participants had taken short positions in anticipation of an increase in yields. Any further increase in price would have forced these participants to cover their positions. Indeed, hedge funds became net buyers of U.S. Treasury securities on the morning of October 15, 2014. The decline in liquidity may have led to a further concern of an inability to exit positions. In particular, although the share of trading volume attributed to PTFs on October 15 does not stand out as unusual relative to the prior period,⁷²⁹ PTFs significantly reduced the dollar amounts of standing quotes in central limit order books,⁷³⁰ leading to greater pressure on the system. This withdrawal of liquidity appears to have been motivated by an attempt to manage risk. Lastly, though broker-dealers increased their trading volume, they provided less liquidity to the

⁷²⁸ See generally Joint Staff Report, *supra* note 4.

⁷²⁹ See Joint Staff Report, *supra* note 4, at 21.

⁷³⁰ See 2021 IAWG Report, *supra* note 4, at 18.

order books by widening their spreads and in some cases withdrawing for brief periods from the offer side of the book.⁷³¹

This disruption showed that market liquidity provision had become more short-term in nature, some liquidity providers were backed by less capital, and liquidity was more vulnerable to shocks as a result of the change in the composition of liquidity providers. In addition, electronic trading permitted rapid increases in orders that removed liquidity. These vulnerabilities are similar to ones observed during the March 2020 events.⁷³² As in the previously described episodes, the price swings illustrate the apparent difficulty for outside capital at accessing the market. Improved market functioning could have allowed economic incentives to help stabilize the system: end-users of U.S. Treasury securities could have reacted to the unusually high prices by selling. However, such participants would have needed access to pricing and to the ability to trade.

7. Affected Parties

a. **Covered Clearing Agencies for U.S. Treasury Securities: FICC**

Although the requirement to clear eligible secondary market transactions would apply to all U.S. Treasury securities CCAs, FICC's Government Securities Division, as noted previously, is the sole provider of clearance and settlement services for U.S. Treasury securities. FICC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation (DTCC); DTCC is a private corporation whose common shares are owned by fee-paying participants in DTCC's clearing agency subsidiaries, including FICC.⁷³³ In 2022 and 2021, FICC's total clearing revenue

⁷³¹ *See id.*

⁷³² *See id.*

⁷³³ *See generally* Notice of No Objection to Advance Notices, Exchange Act Rel. No. 74142 (Jan. 27, 2015), 80 FR 5188 (Jan. 30, 2015) (not objecting to a proposal that DTCC's new common share ownership formula will be based solely on fees paid to its subsidiary clearing agencies).

was approximately \$312.8 million and \$310.0 million, respectively, and its net income was approximately \$4.6 million and \$13.4 million, respectively.⁷³⁴

The G-30 Report estimated that “roughly 20 percent of commitments to settle U.S. Treasury security trades are cleared through FICC.”⁷³⁵ Although various analyses have noted the increased volume of secondary market U.S. Treasury transactions that are not centrally cleared,⁷³⁶ the dollar value of transactions FICC clears remains substantial. In 2022, FICC’s GSD processed \$1.512 quadrillion in DVP transactions of U.S. Government securities.⁷³⁷ In March 2020, clearing dollar volume in U.S. Treasury securities at FICC rose “to over \$6 trillion daily, an almost 43 percent increase over the usual daily average of \$4.2 trillion cleared [at that time].”⁷³⁸

There are differences between the degree of central clearing in the cash and the repo markets. Based on 2017 data, the TMPG estimated that 13 percent of cash U.S. Treasury securities transactions are centrally cleared; 68 percent are bilaterally cleared; and 19 percent involve hybrid clearing, in which only one leg of a transaction on an IDB platform is centrally cleared.⁷³⁹ A Federal Reserve staff analysis of primary dealer repo and reverse repo transactions during the first half of 2022 found “that approximately 20 percent of all repo and 30 percent of

⁷³⁴ FICC, Consolidated Financial Statements as of and for the Years Ended Dec. 31, 2022 and 2021, *available at* <https://www.dtcc.com/-/media/Files/Downloads/legal/financials/2023/DTCC-Annual-Financial-Statements-2022-and-2021.pdf>.

⁷³⁵ G-30 Report, *supra* note 5, at 11.

⁷³⁶ *See, e.g.*, 2021 IAWG Report, *supra* note 4, at 5-6 (citing TMPG White Paper); U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities Capital Markets (Oct. 2017), *available at* <https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf> (“2017 Treasury Report”), at 81; Joint Staff Report, *supra* note 4, at 36-37.

⁷³⁷ Performance Dashboard, DTCC 2022 Annual Report, at 44, *available at* <https://www.dtcc.com/about/-/media/Files/Downloads/Annual-Report-2022/DTCC2022AR-PRINT.pdf>. FICC’s GSD also process U.S. Government securities that are not U.S. Treasury securities but the dollar amount processed of such securities is believed to be nominal by comparison to that of U.S. Treasury securities.

⁷³⁸ DTCC May 2021 White Paper, *supra* note 307, at 3.

⁷³⁹ *See* 2021 IAWG Report, *supra* note 4, at 30; *see also* TMPG White Paper, *supra* note 13, at 12.

reverse repo is centrally cleared via FICC.”⁷⁴⁰ Measured by dollar volume, repos, according to DTCC, are the largest component of the government fixed-income market.⁷⁴¹ In mid-July 2021, according to Finadium and based on DTCC data, FICC processed \$1.15 trillion in repo, or roughly 25 percent of the \$4.4 trillion U.S. repo market at that time.⁷⁴² For all of 2022, DTCC reported that FICC processed \$235 trillion through its GCF Repo Service.⁷⁴³

b. Direct Participants at U.S. Treasury Securities CCAs: FICC Netting Members

The requirement to clear eligible secondary market transactions would directly affect market participants that are direct participants in a U.S. Treasury securities CCA, which currently means only direct participants at FICC’s GSD. FICC direct participants are also referred to as FICC Netting Members. As previously discussed, FICC Netting Members are the only FICC members eligible to become a counterparty to FICC to a U.S. Treasury securities transaction, including repo and reverse repo trades. As of August 14, 2023, FICC’s GSD had 208 Netting Members of which 192 were participants in FICC’s repo netting service.⁷⁴⁴ FICC Netting Members generally consist of bank-affiliated dealers and registered broker-dealers. These dealers

⁷⁴⁰ See Sebastian Infante et al., *supra* note 75 (“Form FR2004 data only cover activities of primary dealers. Therefore, any estimate based on that data is likely to underestimate the total size of the repo market. Discussions with market participants suggest that the nonprimary dealer’s market share is smaller than that attributed to the primary dealers, but growing.”). The authors also show that all cleared bilateral repo and reverse repo have U.S. Treasury securities and TIPS as collateral (the authors’ Figure 4); Viktoria Baklanova, Adam Copeland, and Rebecca McCaughrin, Reference Guide to U.S. Repo and Securities Lending Markets, N.Y. Fed. Staff Report No. 740, at 11 (rev. Dec. 2015), available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr740.pdf.

⁷⁴¹ DTCC, *A Guide to Clearance and Settlement, Chapter 8: Settling Debt Instruments*, available at <https://www.dtcc.com/clearance-settlement-guide/#/chapterEight> (last visited Dec. 12, 2023).

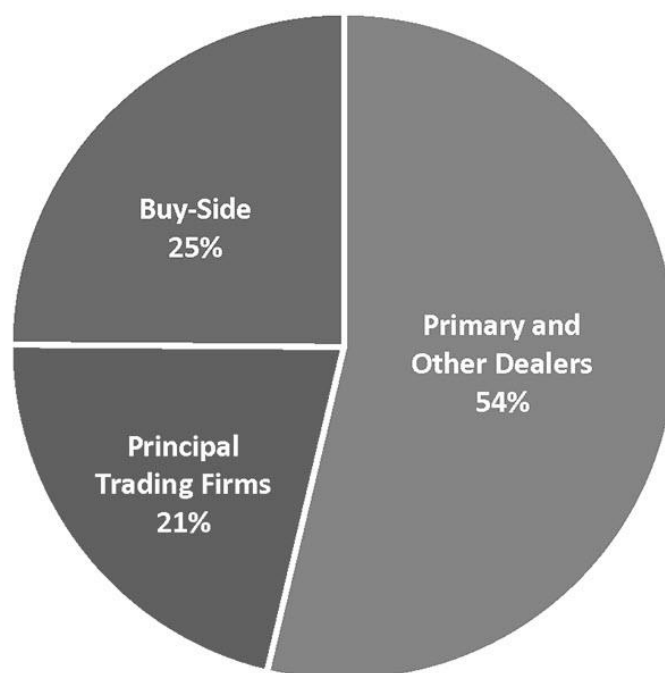
⁷⁴² FINADIUM, BUILDING OUT INDUSTRY DATA FOR NEW INDUSTRY NEEDS 9 (2021), available at <https://finadium.com/wp-content/pdfs/finadium-dtcc-building-out-repo-data.pdf>.

⁷⁴³ DTCC 2022 Annual Report, *supra* note 737, at 44.

⁷⁴⁴ DTCC, *FICC GSD Member Directory* (Oct. 31, 2023), available at <https://www.dtcc.com/-/media/Files/Downloads/client-center/FICC/Mem-GOV-by-name.xlsx> (107 Netting Members participated in FICC’s GCF service).

include all 24 financial institutions currently designated by the Federal Reserve Bank of New York (N.Y. Fed) as “primary dealers.”⁷⁴⁵ In 2022, the average daily trading dollar value in U.S. Treasury securities by primary dealers was \$614.3 billion.⁷⁴⁶ The relative significance of dealer trading in the cash market for U.S. Treasury securities is shown in Figure 8.

Figure 8 Share of U.S. Treasury Securities Cash Market Activity for All Securities by Participant Type



Source: FINRA TRACE. This figure plots shares of trading volume by participant type for the entire U.S. Treasury securities cash market from April 1, 2019, to Dec. 31, 2019. Figure from Harkrader and Puglia FEDS Notes, *supra* note 641. Note: “Buy-side share is assumed to capture institutions such as hedge funds and investment firms but may also include other financial institutions such as banks.” *Id.*

⁷⁴⁵ Primary dealers are counterparties to the N.Y. Fed in its implementation of monetary policy and expected to participate meaningfully in all U.S. Treasury securities auctions for new issuances of U.S. Treasury securities. US Dept of the Treasury, Primary Dealers, available at <https://home.treasury.gov/policy-issues/financing-the-government/quarterly-refunding/primary-dealers>. For a current list of primary dealers see List of Primary Dealers, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/markets/primarydealers>.

⁷⁴⁶ SIFMA, 2023 Capital Markets Fact Book, at 56 (July 2023) available at <https://www.sifma.org/wp-content/uploads/2022/07/2023-SIFMA-Capital-Markets-Factbook.pdf> (SIFMA’s term primary dealers refers to N.Y. Fed prime brokers). *Id.* The dollar value of trading in U.S. Treasury securities by primary dealers has a combined average annual growth rate of 1.7% for the 10-year period ending in 2022.

As previously discussed, the total notional transactions amount in the repo market is larger than that of the cash U.S. Treasury securities market. In 2021, average aggregate daily primary dealer outstanding total repo positions were \$4.3 trillion consisting of \$2.5 trillion in repo (75% of which is collateralized by U.S. Treasury securities) and \$1.8 trillion in reverse repo (89% of which is collateralized by U.S. Treasury securities).⁷⁴⁷ As of December 31, 2021, the repo market as a whole was valued at approximately \$5.8 trillion.⁷⁴⁸ Although a large portion of this activity is cleared by FICC, a large portion is also not centrally cleared. For 2021, DTCC reported that “FICC matches, nets, settles and risk manages repo transactions valued at more than \$3T daily.”⁷⁴⁹ During the first half of 2022, Federal Reserve staff estimated that a “large fraction of primary dealers’ repo (38 percent) and reverse repo (60 percent) activity is in the uncleared bilateral segment.”⁷⁵⁰ See Figure 9. Although these statistics include all collateral types, for the subset of the repo market that includes a primary dealer on one side, the Commission has more detailed data. As Figures 10 and 11 show, the vast majority of uncleared bilateral and triparty primary dealer repo and reverse repo collateral consists of U.S. Treasury securities (including TIPS). The largest remaining components of repo (approximately 40 percent) and reverse repo activity

⁷⁴⁷ SIFMA Research, *US Repo Markets: A Chart Book*, at 6, 7, and 8 (Feb. 2022), available at <https://www.sifma.org/wp-content/uploads/2022/02/SIFMA-Research-US-Repo-Markets-Chart-Book-2022.pdf>. Because these are figures for primary dealer repo and reverse repo, they need not be equal. In the aggregate, however, repo must equal reverse repo.

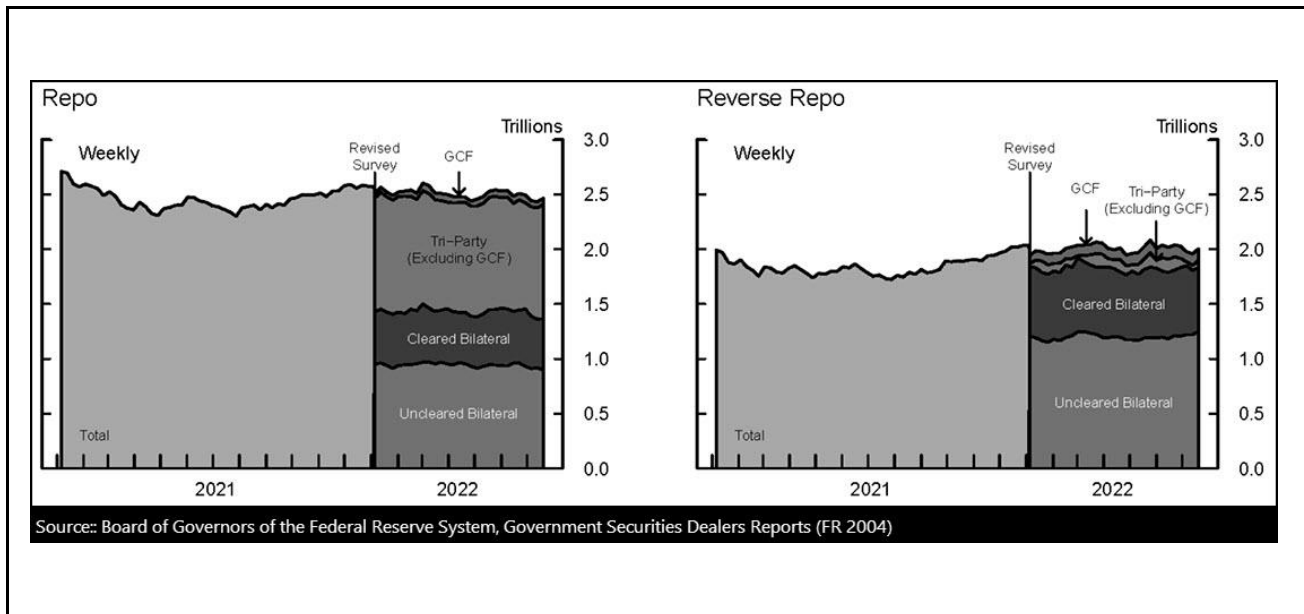
⁷⁴⁸ The Financial Accounts of the United States, L.207, line 1 (Federal Funds and Security Repurchase Agreements) available at <https://www.federalreserve.gov/releases/z1/20220310/html/l207.htm>. This number includes federal funds and security repurchase agreements (for all collateral types). Federal funds outstanding on Dec. 31, 2021, was \$49B. *Effective Federal Funds Rate*, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/markets/reference-rates/effr>. The comparable figures for Dec. 31, 2022, were \$6.6T and \$67B. The Financial Accounts of the United States, L.207, line 1 (Federal Funds and Security Repurchase Agreements), available at <https://www.federalreserve.gov/releases/z1/20230608/html/l207.htm> and *Effective Federal Funds Rate*, Federal Reserve Bank of New York, available at <https://www.newyorkfed.org/markets/reference-rates/effr>.

⁷⁴⁹ DTCC 2021 Annual Report, *supra* note 737, at 32.

⁷⁵⁰ Sebastian Infante et al., *supra* note 75.

(approximately 8 percent) are not centrally cleared but settle on the triparty platform.⁷⁵¹ This is labeled “Tri-Party (excluding GCF)” in Figure 9, and the degree to which Treasury collateral is used in these transactions is displayed in Figure 11. The final and by far the smallest component of repo and reverse repo activity (amounting to about 2% of activity) is triparty repo using FICC’s Sponsored GC service.⁷⁵²

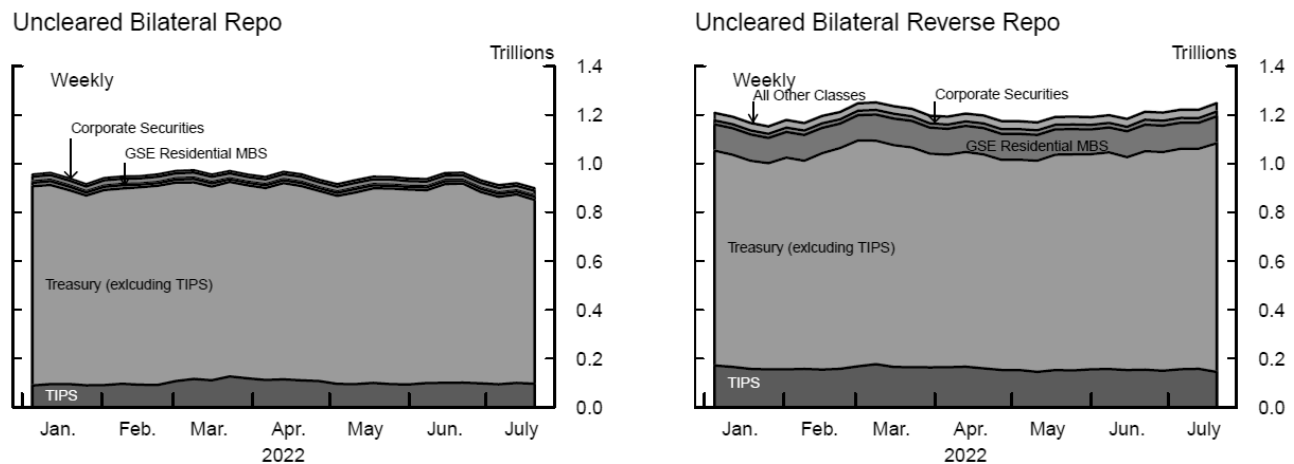
Figure 9 Repo Clearing 2021 – 2022



⁷⁵¹ While the concentration among the top three dealers in the U.S. Treasury securities (excluding Strips) tri-party repo market ranged between 22% and 50% between 2011 and 2020, between Jan. 2021 and Nov. 2022, the percentage of the volume in this market attributable to the top three dealers grew from 33.8 percent to 77.6% before falling to 67.7% by July 2023. NY Fed, Data & Statistics, *Visualization Tri-Party/GCF Repo*, available at <https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo/index.html-interactive/concentration>.

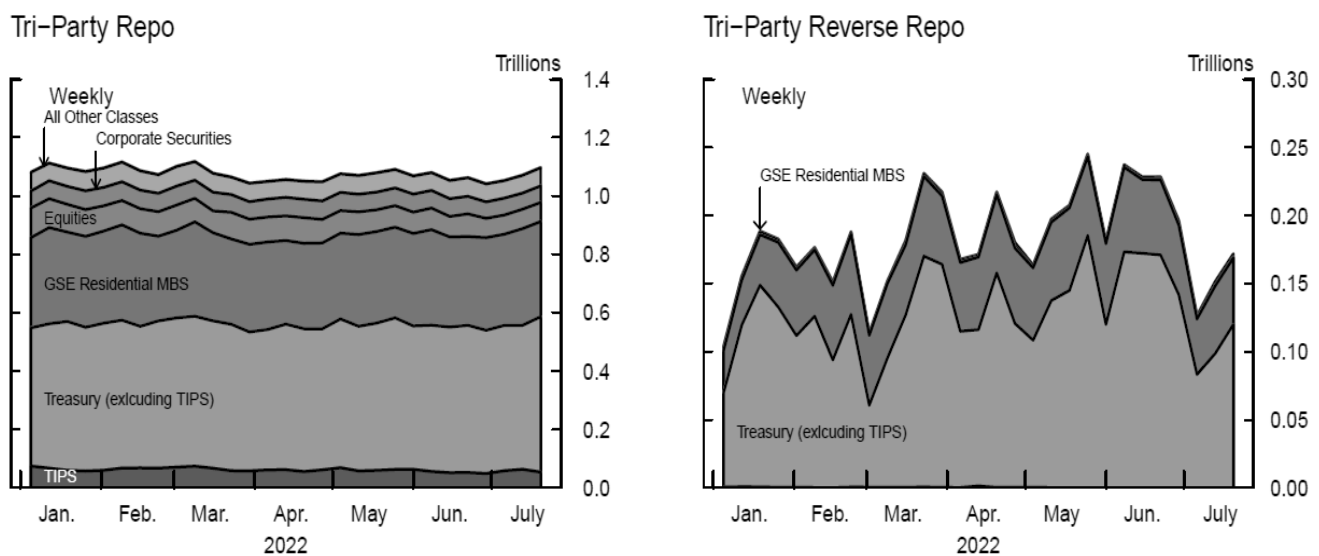
⁷⁵² *Id.*

Figure 10 Uncleared Bilateral Repo and Reverse Repo Collateral 2022



Source: Board of Governors of the Federal Reserve System, Government Securities Dealers Reports (FR 2004)

Figure 11 Tri-party Repo and Reverse Repo Collateral 2022



Source: Board of Governors of the Federal Reserve System, Government Securities Dealers Reports (FR 2004)

c. Interdealer Brokers

Interdealer brokers⁷⁵³ and the trading platforms they operate play a significant role in the markets for U.S. Treasury securities. As previously discussed, an IDB will generally provide a trading facility for multiple buyers and sellers for U.S. Treasury securities to enter orders at specified prices and sizes and have these orders displayed anonymously to all users. When a trade is executed, the IDB then books two trades, with the IDB functioning as the principal to each respective counterparty, thereby protecting the anonymity of each party, but taking on credit risk from each of them. Although there is no legal requirement for an IDB to be a FICC direct participant / Netting Member, most IDBs are FICC Netting Members.⁷⁵⁴ Under FICC's existing rules, if an IDB's customer in a U.S. Treasury security transaction is not a FICC member, the IDB's transaction with that customer need not be centrally cleared and may be bilaterally cleared. As discussed in the Proposing Release and in parts II.A.1 and II.A.2.b.ii *infra*, each transaction at an IDB is split into two pieces: a leg between the buyer and the IDB and a leg between the IDB and the seller.⁷⁵⁵ If the buyer or seller is a dealer, the respective leg is centrally cleared. Transaction legs involving PTFs are generally not cleared and settled bilaterally.

TMPG estimates that “roughly three-quarters of IDB trades clear bilaterally.”⁷⁵⁶ To help visualize the significance of the role played by IDBs in the centrally cleared market, and given existing data limitations, Table 3, adapted from a table prepared by the TMPG in 2019, presents

⁷⁵³ As noted previously, IDB is not used to encompass platforms that provide voice-based or other non-anonymous methods of bringing together buyers and sellers of U.S. Treasury securities. IDB instead refers to electronic platforms providing anonymous methods of bringing together buyers and sellers.

⁷⁵⁴ See generally TMPG White Paper, *supra* note 13. The TMPG White Paper assumes throughout that IDBs are CCP direct members (*e.g.*, “More specifically, the IDB platforms themselves and a number of platform participants continue to clear and settle through the CCP.” *Id.* at 2).

⁷⁵⁵ See *supra* note 14, 87 FR at 64615.

⁷⁵⁶ TMPG White Paper, *supra* note 13, at 2.

five clearing and settlement case types that cover the vast majority of secondary market cash trades. The table uses Federal Reserve data collected from primary dealers in the first half of 2017 to estimate the daily volume (dollar and share percentage) attributable to each clearing and settlement case type.

Table 3: Estimated Secondary Cash Market Primary Dealer Daily Trading Dollar (Billions) and Percentage Volume by Clearing and Settlement Type				
Clearing and Settlement Type	\$ Volume billions	Non-IDB share	IDB Share	Overall Percentage
Bilateral clearing, no IDB	\$289	95%	-	54.3%
Central clearing, no IDB	\$15	5%	-	2.9%
Central clearing, with IDB	\$52	-	22.9%	9.8%
Bilateral clearing, with IDB	\$73	-	31.9%	13.6%
Bilateral/central clearing, with IDB	\$103	-	45.3%	19.4%
Totals:	\$531	\$304 (57.2%)	\$228 (42.8%)	100%
Source: TMPG White Paper, <i>supra</i> note 13, adapted from a table at p. 12.				
Table 3 Notes: Figures are estimated using the Federal Reserves' Form FR2004 data for the first half of 2017 and are based on the following assumptions: a) primary dealers account for all dealer activity, b) 5% of dealers' trading not through an IDB is with another dealer, c) the shares of dealer and non-dealer activity in the IDB market for coupon securities equal the weighted averages of the shares reported in the Oct. 15 report (that is, 41.5% and 58.5%, respectively), d) only dealers trade bills, FRNs, and TIPS in the IDB market, and e) the likelihood of dealer and non-dealers trading with one another in the IDB market solely reflects their shares of overall volume. The table presents estimates because precise information is not available on the size of the market or on how activity breaks down by the method of clearing and settlement.				

d. Other Market Participants

As discussed previously, FICC netting members are generally registered broker-dealers or banks. Some institutional participants that are not FICC Netting Members/FICC direct participants are able to centrally clear repos through FICC's Sponsored Service.⁷⁵⁷

In addition to Sponsored Members, various types of direct and indirect market participants hold significant amounts of U.S. Treasury securities and repo, and potentially purchase and sell U.S. Treasury securities in the secondary cash and repo markets. To the extent that these persons

⁷⁵⁷ FICC's Sponsored Member program also allows the submission of cash transactions; however, as previously noted, the service is generally used only for U.S. Treasury repo transactions at this time.

engage in secondary market transactions, we expect their trading may be affected by increased central clearing resulting from the adoption of the requirement to clear eligible secondary market transactions.

Other key market participants, some of which are direct participants and some of which are sponsored members that may be affected by the rule include:

i. Broker-Dealers That Are Not Direct Participants/FICC Netting Members

Broker-dealers perform a number of functions in the U.S. securities markets including making markets in securities, brokering securities transactions, dealing securities, executing securities transactions, clearing and settling securities transactions, and maintaining custody of securities for investors. Some broker-dealers may perform multiple functions whereas others may perform a single function.⁷⁵⁸

Based on 2022 annual FOCUS filings, third quarter 2023 FOCUS filings, and FICC list of netting members,⁷⁵⁹ there are 3,215 broker-dealers that are not also FICC netting members. Broker-dealers that are not FICC netting members are typically much smaller than those that are. Average assets of all broker-dealers is approximately \$2.4 billion while the average of non-FICC netting member broker-dealers is approximately \$276 million.

⁷⁵⁸ Using Form BD data from Sept. 2022, the Commission has previously stated that 27% of Form BD filers are U.S. Government Securities Brokers and 10% are U.S. Government Securities Dealers. *See* Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents, Exchange Act Release No. 97142 (Oct. 25, 2022) 87 FR 64610, at 64650-1.

⁷⁵⁹ *See supra* note 744.

ii. Hedge Funds, Family Offices, and Separately Managed Accounts

Hedge funds are active participants in the secondary market for U.S. Treasury securities and their trading activities may be a cause of price movements in the U.S. Treasury securities market.⁷⁶⁰ Hedge funds can use U.S. Treasury securities, for example, in order to borrow cash (i.e., sell repo) to take leveraged positions in other markets, or to execute trading strategies. As of December 31, 2022, approximately 21 percent of Form PF filers⁷⁶¹ that are qualifying hedge funds reported U.S. Treasury securities holdings totaling \$1.70 trillion in notional exposure in the cash market and \$2.13 trillion in notional exposure to repos.⁷⁶²

Family offices are entities established by families to manage family wealth.⁷⁶³ A recent survey of family offices⁷⁶⁴ found that of 385 participating family offices around the world, almost

⁷⁶⁰ Ron Alquist & Ram Yamarthy, *Hedge Funds and Treasury Market Price Impact: Evidence from Direct Exposures* (OFR working paper 22-05, Aug. 23, 2022) (“find[ing] economically significant and consistent evidence that changes in aggregate hedge fund [Treasury] exposures are related to Treasury yield changes [and] ... that particular strategy groups and lower-levered hedge funds display a larger estimated price impact on Treasuries.”), available at <https://www.financialresearch.gov/working-papers/files/OFRwp-22-05-hedge-funds-and-treasury-market-price-impact.pdf>. See also note 720, *supra*.

⁷⁶¹ Qualifying hedge funds refers to those hedge funds that have a net asset value (individually or in combination with any feeder funds, parallel funds and/or dependent parallel managed accounts) of at least \$500 million as of the last day of any month in the fiscal quarter immediately preceding its most recently completed fiscal quarter. See Form PF (Glossary of Terms). Although the Proposal would cover any hedge fund, smaller funds’ holdings are not reflected in these statistics because of Form PF’s minimum \$150 million reporting threshold. An adviser must file Form PF if (1) it is registered (or required to register) with the Commission as an investment adviser, including if it also is registered (or required to register) with CFTC as a commodity pool operator or commodity trading adviser, (2) it manages one or more private funds, and (3) the adviser and its related persons, collectively had at least \$150 million in private fund assets under management as of the last day of its most recently completed fiscal year. See Form PF General Instruction No. 1, available at <https://www.sec.gov/files/formpf.pdf>.

⁷⁶² Division of Investment Management Analytics Office, Private Funds Statistics Fourth Calendar Quarter 2022, Table 46 at 39 (July 22, 2022), available at <https://www.sec.gov/files/investment/private-funds-statistics-2022-q4-accessible.pdf>.

⁷⁶³ “Historically, most family offices have not been registered as investment advisers under the Advisers Act because of the ‘private adviser exemption’ provided under the Advisers Act to firms that advice fewer than fifteen clients and meet certain other conditions.” SEC Staff, *Family Office: A Small Entity Compliance Guide* (Nov. 21, 2011), available at <https://www.sec.gov/rules/final/2011/ia-3220-secg.htm>.

⁷⁶⁴ Campden Wealth & The Royal Bank of Canada, *The North America Family Office Report 2021*, available at <https://www.rbcwealthmanagement.com/assets/documents/cmp/the-north-america-family-office-report-2021-final-ua.pdf>.

half (46%) are based in North America. Average family office AUM for North American families was \$1 billion.

Similarly, Separately Managed Accounts (SMAs) are also portfolios of assets managed by an investment adviser, usually targeted towards institutional investors and wealthy individual investors. Because of the end investor's risk tolerance, SMAs can also pursue high-risk, leveraged strategies.

iii. Registered Investment Companies (RICs) Including Money Market Funds, Other Mutual Funds, and ETFs

RICs, mainly money market funds, mutual funds, and ETFs, are large holders of U.S. Treasury securities.⁷⁶⁵ At the end of the first quarter of 2023, money market funds held \$1.0 trillion of U.S. Treasury securities (\$185 billion in T-Bills and \$856 billion in other U.S. Treasury securities).⁷⁶⁶ Mutual funds held an additional \$1.4 trillion of other U.S. Treasury securities (\$14 billion of T-Bills and \$1.4 trillion of other U.S. Treasury securities) while exchange-traded funds held an additional \$452.4 billion in U.S. Treasury securities.⁷⁶⁷ The degree to which these entities

⁷⁶⁵ As of Mar. 2022, investment companies were the third largest holder of U.S. Treasury securities holding just under \$3.6 trillion. Viktoria Baklanova, Isaac Kuznits, Trevor Tatum, *Money Market Funds in the Treasury Market* (Sept. 1, 2022), available at <https://www.sec.gov/files/mmfs-treasury-market-090122.pdf> ("MMFs in the Treasury Market"), at 3 (citing to Financial Accounts of the United States as of Mar. 2022). The other large (over 5%) holders are: "other" holders (including hedge funds) 30%, the Federal Reserve (23 percent), pension funds (14%), and U.S. banks and state and local governments (each holding 6%). See *id.* at 2 (figure 5).

⁷⁶⁶ Federal Reserve Statistical Release, *Z.1 Financial Accounts of the U.S, Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts*, at 119 (L210 Treasury Securities - lines 42 – 49) ("Financial Accounts of the U.S."), available at <https://www.federalreserve.gov/releases/z1/20220609/z1.pdf>.

⁷⁶⁷ *Id.* at 119 (L210 Treasury Securities - lines 45 – 47 and 49). Filings of Form N-MFP by money market funds show that, as of May 31, 2023, these funds invested approximately \$2.8 trillion in Treasury repos. In addition, mutual funds invested \$27 billion in repurchase agreements, including those backed by Treasury securities. See *supra* note 118 and referencing text.

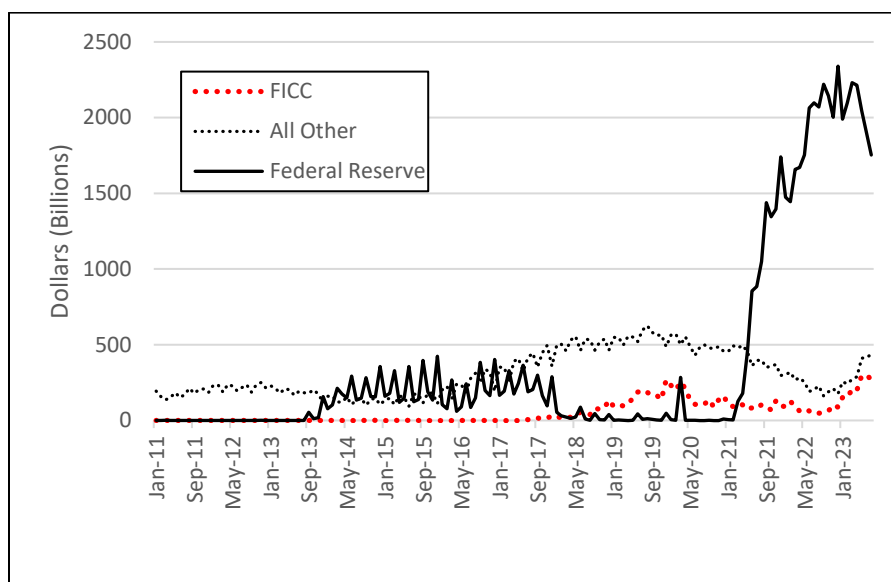
would be affected depends on the extent to which their trading is likely to take place in the secondary market.⁷⁶⁸

RICs are also active participants in the repo market with money market funds being active cash investors in U.S. Treasury repo. According to data filed with the Commission, money market funds' investments in U.S. Treasury repo, both bilateral and triparty, amounted to approximately \$2.46 trillion in June 2023. Moreover, as shown in Figure 12, money market fund U.S. Treasury repo volume has grown from approximately \$200 billion monthly in 2011 with the vast majority of the most recent year's growth attributed to investments in the Federal Reserve's repo facility.⁷⁶⁹

⁷⁶⁸ For example, an analysis of money market fund portfolios' turnover of U.S. Treasury securities by the Commission staff indicates only limited secondary market trading activity. Estimates based on monthly filings of Form N-MFP suggest that, on average, money market funds hold around 70% of U.S. Treasury securities to the next month with around 6% of U.S. Treasury securities holdings disposed of before maturity. The remaining approximately 23% of holdings mature during the month. MMFs in the Treasury Market, *supra* note 765, at 3. These estimates suggest that the final rule's effect on money market fund cash market transactions in U.S. Treasury securities will be very limited relative the final rule's effects on money market funds' repo activities which could be more significant.

⁷⁶⁹ *Id.* at 4. The Commission understands the credit rating agencies consider concentration of counterparty credit risk as one factor in determining their rating of money market funds which may drive money market funds to seek diversification of counterparties for the repo transactions.

Figure 12: Total Monthly Repo Volume by Money Market Funds by Counterparty Type Monthly Repo Volume (01/2011 - 07/2023)



Source: SEC Form N-MFP as summarized by OFR, *available at* <https://www.financialresearch.gov/money-market-funds/us-mmfs-investments-in-the-repo-market/>.

For RICs, holdings of U.S. Treasury securities play an important role in managing liquidity risk stemming from potential redemptions. Given their highly liquid nature, U.S. Treasury securities can be used to raise cash to meet redemptions. For example, a survey conducted by an industry group showed that in the first quarter of 2020 mutual funds had net sales of \$128 billion in Treasury and agency bonds, mainly to meet redemption requests at the onset of the Covid-19 pandemic.⁷⁷⁰

In addition to reliance on Treasury securities as sources of liquidity, RICs use Treasury securities as another source of liquidity by selling repo. Also, RICs accept Treasury securities as collateral in their securities lending programs established as an additional source of income for the fund shareholders. In July of 2023, the Commission adopted amendments to certain rules that

⁷⁷⁰ See Shelly Antoniewicz & Sean Collins, *Setting the Record Straight on Bond Mutual Funds' Sales of Treasuries*, ICI VIEWPOINTS (Feb. 24, 2022), *available at* <https://www.ici.org/viewpoints/22-view-bondfund-survey-2>.

govern money market funds, that among other things, increased daily and weekly liquid asset minimums.⁷⁷¹ As direct obligations of the U.S. Government, including U.S. Treasury securities, are included in the definition of both daily and weekly liquid assets,⁷⁷² to the extent that money market funds currently fall below the minimums, their holdings of U.S. Treasuries may increase.

iv. Principal Trading Firms (PTFs)

The role and importance of PTFs providing liquidity in the U.S. Treasury securities market have been the subject of a number of analyses and reports in recent years.⁷⁷³ For example, using FINRA’s Regulatory TRACE data in connection with a recent rulemaking proposal, we identified 174 market participants who were active in the U.S. Treasury securities market in July 2021 and

⁷⁷¹ See Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A, Investment Advisors Act Release No. 6344 (Aug. 3, 2023), 88 FR 51404 (“Money Market Reforms Adopting Release”).

⁷⁷² See *supra* note 771, at 51431.

⁷⁷³ See, e.g., G-30 Report, *supra* note 5, at 1; Joint Staff Report, *supra* note 4, at 3-4, 36, 55 (“PTFs now account for more than half of the trading activity in the futures and electronically brokered interdealer cash markets.”); Harkrader and Puglia FEDS Notes, *supra* note 641; Doug Brain, Michiel De Pooter, Dobrislav Dobrev, Michael Fleming, Pete Johansson, Collin Jones, Frank Keane, Michael Puglia, Liza Reiderman, Tony Rodrigues, and Or Shachar, *Unlocking the Treasury Market Through TRACE* (FEDS Notes, Sept. 28, 2018), available at <https://www.federalreserve.gov/econres/notes/feds-notes/unlocking-the-treasury-market-through-trace-20180928.htm>. See also Peter Ryan and Robert Toomey, *Improving Capacity and Resiliency in US Treasury Markets: Part III* (Nov. 15, 2021), available at <https://www.sifma.org/resources/news/improving-capacity-and-resiliency-in-us-treasury-markets-part-3/>. (While in the interdealer cash market, U.S. Treasury securities are often cleared and settled through FICC, “dealer trades with principal trading firms (“PTFs”) – a very large share of this market – are generally cleared bilaterally because most PTFs are not members of the FICC.”). See also 2021 IAWG Report, *supra* note 4, at 21 (“on February 25, 2021, a large shift in investor sentiment triggered very high trading volumes [] that temporarily overwhelmed the intermediation capacity of the Treasury market. Some market participants observed that the stresses on February 25, 2021, were exacerbated by lack of elasticity in liquidity supply resulting from activity limits that IDB platforms impose on some firms, especially PTFs that do not participate in central clearing.”).

were not members of FINRA.^{774,775} We “found that these participants accounted for approximately 19 percent of the aggregate U.S. Treasury security trading volume, with PTFs representing the highest volumes of trading among these participants.”⁷⁷⁶ We explained that in our analysis:

PTFs had by far the highest volumes among identified non-FINRA member participants in the U.S. Treasury market, and the largest PTFs had trading volumes that were roughly comparable to the volumes of the largest dealers. A Federal Reserve staff analysis found that PTFs were particularly active in the interdealer segment of the U.S. Treasury market in 2019, accounting for 61 percent of the volume on [electronic] interdealer broker platforms⁷⁷⁷

Based on this Federal Reserve study and assuming that all PTFs are not FICC members and that PTF trading on IDB electronic platforms during the final three quarters 2019 was a reasonable proxy for the average daily current volume of such trading today by PTFs, the requirement to clear eligible secondary market transactions would subject as much as approximately \$116.51 billion per day in PTF trades on electronic/automated IDBs to central clearing.⁷⁷⁸

⁷⁷⁴ Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer, Exchange Act Rel. No. 94524 (Mar. 28, 2022), 87 FR 23054, 23072, and 23080 (Apr. 18, 2022) (“Because regulatory TRACE data pertaining to Treasury securities reported by certain ATSs contains the identity of non-FINRA member trading parties, we are able to analyze PTFs’ importance in the U.S. Treasury market during July 2021 and summarize the number and type of market participants by monthly trading volume . . .”). “Although FNRA membership is not synonymous with dealer registration status, the Commission believes that many of the market participants who are not FINRA members are also likely not registered as government securities dealers.” *Id.* at 23072 n. 167.

⁷⁷⁵ In Aug. 2023, the SEC adopted amendments to an exemption from the requirement for certain broker-dealers to join a national securities association. The amendments will, among other effects, enhance the oversight of participants in Treasury markets and the transparency of the market by requiring certain broker-dealers significantly involved in the proprietary trading of Treasury securities to become FINRA members and report their Treasury transactions to TRACE. *See* Exemption for Certain Exchange Members, Exchange Act Release No. 98202 (Sept. 7, 2023), 88 FR 61850 (“Exemption for Certain Exchange Members Release”).

⁷⁷⁶ *Id.* at 23072.

⁷⁷⁷ *Id.* at 23080. Harkrader and Puglia FEDS Notes, *supra* note 641. *See also* Doug Brain et al. *supra* note 773. Harkrader and Puglia used FINRA TRACE data on the trading volume shares of different participant types on IDB platforms for nominal coupon securities from April 1, 2019, to Dec. 31, 2019. They identified \$191 billion of average daily dollar volume on electronic/automated IDB platforms during the period. They also noted data limitations, which they estimated amounted to “a very small fraction of total activity.” *Id.*

⁷⁷⁸ Harkrader and Puglia FEDS Notes, *supra* note 641, at table 1 (61% of \$191 billion = \$116.51 billion).

v. State and Local Governments

According to the United States Census Bureau's 2017 Census of Governments data, there were over 90,000 local governments in the United States, including county, city, municipality, township, and special purpose governments as well as nearly 13,000 independent school district governments.⁷⁷⁹ These state and local governments are significant holders of U.S. Treasury securities. As of March 2023, state and local governments held approximately \$1.6 trillion in U.S. Treasury securities⁷⁸⁰ as part of their budgetary and short-term investment duties.

vi. Private Pensions Funds and Insurance Companies.

Insurance companies and pension funds also have significant positions in U.S. Treasury securities. As of March 2023, private pension funds and insurance companies are large holders of U.S. Treasury securities, holding \$479.3 billion and \$405.9 billion respectively.⁷⁸¹

e. Triparty Agent: Bank of New York Mellon⁷⁸²

Although triparty repo transactions are bilaterally negotiated, they are settled through BNY Mellon, which currently plays a central role in the triparty repo market as the sole triparty agent.⁷⁸³ Besides providing collateral valuation, margining, and management services, BNY Mellon also provides back-office support to both parties by settling transactions on its books and confirming that the terms of the repo are met. Additionally, the clearing bank acts as custodian for the

⁷⁷⁹ 2017 Census of Governments – Organization, Table 2: Local Governments by Type and State: 2017 & Table 9: Public School System by Types of Organization and State: 2017, U.S. CENSUS BUREAU, <https://www.census.gov/data/tables/2017/econ/gus/2017-governments.html>.

⁷⁸⁰ Financial Accounts of the U.S., *supra* note 766 (Line 19).

⁷⁸¹ *Id.* (Lines 29, 32, and 35).

⁷⁸² Paddrik et al., *supra* note 631 (“The Federal Reserve Board, through the Federal Reserve Bank of New York (FRBNY), supervises triparty custodian banks and, on a mandatory basis pursuant to its supervisory authority, collects transaction-level data at the daily frequency.”).

⁷⁸³ J.P. Morgan Chase previously served as a custodian in the triparty space but largely exited the market in 2019. *Id.* at 2-3.

securities held as collateral and allocates collateral to trades at the close of the business day. As discussed previously, FICC recently introduced the Sponsored GC Service that extends FICC's GCF repo service to allow for the clearing of triparty repo.⁷⁸⁴

An expansion of central clearing under the requirement to clear eligible secondary market transactions could affect BNY Mellon's triparty business. It is, however, unclear whether increased central clearing would increase or decrease the amount of repo traded that makes use of triparty agent's services previously described.

f. Custodian Banks / Fedwire Securities Service (FSS)

Currently, custodian banks handle much of the trading activity for long-only buy-side clients in the U.S. Treasury securities cash and repo markets. When an asset buyer and seller engage bilaterally as principals in a collateralized securities transaction, a repo for example, a custodian bank will often provide various services to support the transaction. Custodian services include transaction settlement verification, verifying the amount of the relevant credit exposure, calculating required initial and variation margin, and making margin calls. In a triparty repo transaction that is not centrally cleared, a custodian performs a clearing function by settling the transaction on its own books without a corresponding transfer of securities on the books of a central securities depository.⁷⁸⁵

FSS, operated by the Federal Reserve Bank system, provides issuance, maintenance, transfer and settlement services for all marketable U.S. Treasury securities to its 3,800

⁷⁸⁴ Exchange Act Release No. 92808 (Aug. 30, 2021), 86 FR 49580 (Sept. 3, 2021). Currently, the Bank of New York Mellon operates the triparty platform that facilitates trades conducted via the GCF Repo Service and Sponsored GC Service.

⁷⁸⁵ The Clearing House, *The Custody Services of Banks* (July 2016), available at https://www.davispolk.com/sites/default/files/20160728_tch_white_paper_the_custody_services_of_banks.pdf.

participants.⁷⁸⁶ For example, FSS offers the ability to transfer securities and funds to settle secondary-market trades, to facilitate the pledging of collateral used to secure obligations, and to facilitate repo transactions.⁷⁸⁷

C. Analysis of Benefits, Costs, and Impact on Efficiency, Competition, and Capital Formation

1. Benefits

The amendments being adopted will likely yield benefits associated with increased levels of central clearing in the secondary market for U.S. Treasury securities. The Commission previously has stated that “the centralization of clearance and settlement activities at covered clearing agencies allows market participants to reduce costs, increase operational efficiency, and manage risks more effectively.”⁷⁸⁸ These benefits could be particularly significant in times of market stress, as CCPs will mitigate the potential for a single market participant’s failure to destabilize other market participants, destabilize the financial system more broadly, and/or reduce the effects of misinformation and rumors.⁷⁸⁹ A CCP also will address concerns about counterparty risk by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity of counterparties.⁷⁹⁰ However, the Commission has also recognized that this

⁷⁸⁶ See *Fedwire Securities Service* (“FSS brochure”), FRBSERVICES.ORG, <https://www.frb services.org/binaries/content/assets/crsocms/financial-services/securities/securities-product-sheet.pdf>. The Federal Reserve Banks offer highly competitive transaction, per-issue and monthly maintenance prices. Account maintenance fees are waived for accounts holding only U.S. Treasury securities and for certain accounts used to pledge securities to the U.S. Treasury and Federal Reserve Banks. Fees for services are set by the Federal Reserve Banks. See *Fedwire Securities Service 2023 Fee Schedules*, FRBSERVICES.ORG, <https://www.frb services.org/resources/fees/securities-2023>.

⁷⁸⁷ FSS brochure, *supra* note 786.

⁷⁸⁸ See CCA Standards Proposing Release, *supra* note 8, 79 FR at 29587.

⁷⁸⁹ See, e.g., Liffe Order, *supra* note 7, 74 FR at 140.

⁷⁹⁰ *Id.*

centralization of activity at clearing agencies makes risk management at such entities a critical function.⁷⁹¹

Commenter(s) agreed that certain benefits of increased central clearing – increasing liquidity, resilience, and intermediation capacity – exist but disagree that these benefits have been “sufficiently proven” to outweigh the potential costs.⁷⁹² As discussed in part IV.A, *supra*, improvements to market resilience imply potentially large expected benefits as the cost of financial market crises can be high. As discussed in part IV.C.2, *infra*, the Commission acknowledges the costs associated with the rule but believes that some of the costs incurred by market participants are commensurate with the risks and particular attributes of the market participants’ transactions. It further believes that the overall benefits of increased clearing U.S. Treasury Securities transactions discussed below, including improvements to market resiliency, justify the costs.

Bilateral clearing arrangements do not allow for multilateral netting of obligations, which reduce end-of-day settlement obligations.⁷⁹³ Larger gross settlement obligations, which increase with leverage, increase operational risks and subsequently the possibility of settlement fails. Central clearing of transactions nets down gross exposures across participants, which reduces firms’ exposures while positions are open, and typically reduces the magnitude of cash and securities flows required at settlement.⁷⁹⁴ These reductions, particularly in cash and securities flow “would reduce liquidity risks associated with those settlements and counterparty credit risks

⁷⁹¹ *Id.*

⁷⁹² SIFMA/IIB Letter, *supra* note 37, at 1-2.

⁷⁹³ See part IV.A *supra* for a discussion of central clearing and the mitigation of clearance and settlement risks. However, bilateral clearing does allow for balance sheet netting under certain conditions and for margining of net positions that may include multiple asset classes.

⁷⁹⁴ See 2021 IAWG Report, *supra* note 4, at 30.

associated with failures to deliver on the contractual settlement date,” not only for CCP members but for the CCP itself.⁷⁹⁵

It has been suggested that wider central clearing could have lowered dealers’ daily settlement obligations in the cash market by up to 60 percent in the run-up to and aftermath of the March 2020 U.S. Treasury securities market disruption and reduced settlement obligations by up to 70 percent during the disruption itself.⁷⁹⁶ The reduction in exposure is not limited to the cash market; it has been estimated that the introduction of central clearing for dealer-to-client repos would have reduced dealer exposures from U.S. Treasury repos by over 80% (from \$66.5 billion to \$12.8 billion) in 2015.⁷⁹⁷

The benefits of multilateral netting flowing from central clearing can improve market safety by lowering exposure to settlement failures.⁷⁹⁸ Multilateral netting can also reduce the regulatory capital required to support a given level of intermediation activity⁷⁹⁹ and could also enhance capacity to make markets during normal times and stress events because existing bank capital and leverage requirements recognize the risk-reducing effects of multilateral netting of trades that CCP clearing accomplishes.⁸⁰⁰ By reducing the level of margin required to support a

⁷⁹⁵ See G-30 Report, *supra* note 5; see also PIFS Paper, *supra* note 76 at 28-31.

⁷⁹⁶ *Id.* See also Michael Fleming & Frank Keane, *Netting Efficiencies of Marketwide Central Clearing* (Staff Report No. Staff Report No. 964), Federal Reserve Bank Of New York (Apr. 2021) (“Fleming & Keane (2021)”), available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf.

⁷⁹⁷ PIFS Paper, *supra* note 76, at 29 (citing OFFICE OF FINANCIAL RESEARCH, *Benefits and Risks of Central Clearing in the Repo Market*, 5-6 (Mar. 9, 2017) (“2017 OFR Report”), available at https://www.financialresearch.gov/briefs/files/OFRBr_2017_04_CCP-for-Repos.pdf).

⁷⁹⁸ Duffie, *supra* note 27, at 15.

⁷⁹⁹ See part IV.A *supra* for an example of how multilateral netting can reduce margin required to support a given level of trading activity.

⁸⁰⁰ See 2021 IAWG Report, *supra* note 4, at 30; Liang & Parkinson, *supra* note 725, at 9; Duffie, *supra* note 27, at 16-17. It is important to note that this netting may offset any potentially higher liquidity charges faced by major participants from clearing at the CCP. See Duffie, *supra* note 27, at 17 (“To the contrary, the netting of most purchases against sales at a CCP would lower the overall liquidity requirements of dealers, assuming that dealers continue to intermediate the market effectively.”).

given total level of trading activity, central clearing may reduce total risk to the system. Financial crises are sometimes precipitated by margin calls following a period of increased volatility. If a market participant holds offsetting positions, then margin calls that might occur could be avoided. Because financial markets are forward-looking, reducing the anticipation of margin calls on other market participants can avoid costly “bank-run” type dynamics.⁸⁰¹

Some benefits associated with capital reductions are particularly relevant for overnight and term repo. In the case of financing activity in U.S. Treasury securities market – U.S. Treasury repo – the entire notional value of the position has to be recorded on a dealer’s balance sheet as soon as the start leg of the repo settles, and unless the dealer faces the same legal counterparty with respect to an offsetting financing trade of the same tenor, the dealer will not be able to net such balance sheet impact against any other position. The grossing up of the dealer’s balance sheet in this manner can have implications with respect to the amount of capital the dealer is required to reserve against such activity. When transactions are cleared through a CCP, dealers can offset their centrally cleared repo positions of the same tenor, and thereby free up their capital to increase funding capacity to the market.⁸⁰² According to research that Finadium conducted among repo dealers, netting can compress High Quality Liquid Asset (HQLA) bilateral trading books by 60% to 80%.⁸⁰³

⁸⁰¹ See Menkveld and Vuillemeij *supra* note 568.

⁸⁰² The positive impact on dealer’s ability to increase funding capacity will be offset, in part, by the direct and indirect costs of central clearing. See *id.* and part IV.C.2 *infra*. One commenter, although not supporting all aspects of the requirement to clear eligible secondary market transaction, agreed that a clearing mandate applied to bilateral repo transactions would be beneficial, pointing to the balance sheet efficiency resulting from repo clearing. See MFA Letter, *supra* note 81, at 13.

⁸⁰³ Finadium LLC, *Netting Rules for Repo, Securities Lending and Prime Brokerage* (Sept. 2014), available at <https://finadium.com/finadium-report-desc/netting-rules-for-repo-securities-lending-and-prime-brokerage/>. Assets are considered to be HQLA if they can be easily and immediately converted into cash at little or no loss of value. The test of whether liquid assets are of “high quality” is that, by way of sale or repo, their

Cash and repo trades cleared and settled outside of a CCP may not be subject to the same level of uniform and transparent risk management associated with central clearing.⁸⁰⁴ By contrast, FICC is subject to the Commission’s risk management requirements addressing financial, operational, and legal risk management, which include, among other things, margin requirements commensurate with the risks and particular attributes of each relevant product, portfolio, and market.⁸⁰⁵ As the Commission believes that the amendments being adopted will incentivize and facilitate additional central clearing in the U.S. Treasury securities market, risk management should improve. To offset the risks it faces as a central counterparty, the CCP requires its members to post margin, and the CCP actively monitors the positions its members hold. Moreover, in the event that the posted margin is not enough to cover losses from default, the CCP has a loss-sharing procedure that mutualizes loss among its members.

By lowering counterparty risk, central clearing also allows for the “unbundling” of counterparty risk from other characteristics of the asset that is being traded. This unbundling makes the financial market for Treasury securities more competitive.⁸⁰⁶

The Commission also believes that these amendments will help avoid a potential disorderly default by a member of any U.S. Treasury securities CCA. Defaults in bilaterally settled transactions are likely to be disorganized and subject to variable default management techniques,

liquidity-generating capacity is assumed to remain intact even in period of severe idiosyncratic and market stress. See LIQUIDITY COVERAGE RATIO STANDARDS LCR30.2, LCR 30.3 (BASEL COMM. ON BANKING SUPERVISION 2019), available at https://www.bis.org/basel_framework/chapter/LCR/30.htm?tldate=20191231&inforce=20191215.

⁸⁰⁴ See TMPG Repo White Paper, *supra* note 75.

⁸⁰⁵ G-30 Report, *supra* note 5, at 13; 17 CFR 240.17ad-22(e)(6).

⁸⁰⁶ “One of the conditions for a perfectly competitive market is that [market participants] are happy to [buy or sell] from any of the many [sellers or buyers] of the [asset]. No [buyer or seller] of the [asset] has any particular advantage ...” David M. Kreps, “A Course in Microeconomic Theory” Princeton University Press (1990), at 264 (describing the conditions of a perfectly competitive market.) When the transaction is novated to the CCP, market participants substitute the default risk of the CCP for that of the original counterparty.

often subject to bilaterally negotiated contracts with potentially limited uniformity. Independent management of bilateral credit risk creates uncertainty about the levels of exposure across market participants and may make runs more likely; any loss stemming from closing out the position of a defaulting counterparty is a loss to the non-defaulting counterparty and hence a reduction in its capital in many scenarios.⁸⁰⁷

Increased use of central clearing should enhance regulatory visibility in the critically important U.S. Treasury securities market. Specifically, central clearing increases the transparency of settlement risk to regulators and market participants and, in particular, allows the CCP to identify concentrated positions and crowded trades, adjusting margin requirements accordingly, which should help avoid significant risk to the CCP and to the system as a whole.⁸⁰⁸

As discussed further below, the Commission is unable to quantify certain economic benefits of these amendments. The Commission solicited comment, including estimates and data from interested parties, that would help inform the estimates of the economic effects of the amendments but received only limited data, discussed further in part IV.C.2.a *infra*, that could be used to improve these estimates.

a. U.S. Treasury Securities CCA Membership Requirements

The Commission is amending Rule 17ad-22(e)(18) to require any covered clearing agency that provides central counterparty services for transactions in U.S. Treasury securities to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, require that direct participants of a covered clearing agency submit all eligible secondary market U.S. Treasury securities transactions in which they enter for clearing at a

⁸⁰⁷ See TMPG White Paper, *supra* note 13, at 32.

⁸⁰⁸ Duffie, *supra* note 27, at 15; DTCC October 2021 White Paper, *supra* note 681, at 1; 2021 IAWG Report, *supra* note 4.

covered clearing agency.⁸⁰⁹ As previously explained in part II.A.2 *supra*, as proposed an eligible secondary market transaction in U.S. Treasury securities was defined to include: (1) repurchase agreements and reverse repurchase agreements in which one of the counterparties is a direct participant; (2) any purchases and sales entered into by a direct participant that is an interdealer broker, meaning if the direct participant of the covered clearing agency brings together multiple buyers and sellers using a trading facility (such as a limit order book) and is a counterparty to both the buyer and seller in two separate transactions; (3) any purchases and sales of U.S. Treasury securities between a direct participant and a counterparty that is either a registered broker-dealer, government securities dealer, or government securities broker; a hedge fund⁸¹⁰; or an account at a registered broker-dealer, government securities dealer, or government securities broker where such account may borrow an amount in excess of one-half of the net value of the account or may have gross notional exposure of the transactions in the account that is more than twice the net value of the account.⁸¹¹ However, any transaction (both cash transactions and repos) where the counterparty to the direct participant of the CCA is a central bank, sovereign entity, international financial institution, or a natural person would be excluded from the definition of an eligible secondary market transaction.

⁸⁰⁹ See part II.A.1 *supra*.

⁸¹⁰ For the purpose of the proposed rule, a hedge fund is defined as any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). This definition of a hedge fund is consistent with the Commission's definition of a hedge fund in Form PF. See Proposing Release, *supra* note 14 at 64623.

⁸¹¹ *Id.*

In a change from the proposal, the Commission is modifying the definition of an eligible secondary market transaction in Rule 17ad-22(a) to conditionally exclude inter-affiliate transactions.⁸¹² Specifically, the Commission is excluding from that definition any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities entered into between a direct participant and an affiliated counterparty, provided that the affiliated counterparty submit for clearance and settlement all other repurchase or reverse repurchase agreements collateralized by U.S. Treasury securities to which the affiliated counterparty is a party.⁸¹³

As discussed in part II.A.2.a.vi, *supra*, inter-affiliate transactions are used to transfer liquidity and risk within an affiliated group. These transactions may serve different purposes, including, but not limited to, providing U.S. Treasury securities for delivery when an affiliate has taken a long or short position in U.S. Treasury securities as a hedge against other exposures, allowing the movement of U.S. Treasury securities to allow them to be posted as margin on an affiliate's transaction, ensuring that U.S. Treasury securities can serve as a liquidity buffer for an affiliated bank,⁸¹⁴ or to meet liquidity composition targets. To get the U.S. Treasury securities to the appropriate entity with an affiliated group, the affiliate often enters into repos or reverse repos with a direct participant of a U.S. Treasury securities CCA.

As discussed above, one commenter stated that requiring inter-affiliate transactions to be centrally cleared would impose additional costs with limited benefits.⁸¹⁵ While the costs of clearing inter-affiliate transactions may be similar to those of other transactions, the Commission agrees with the commenter that the potential benefits of clearing these transactions is likely to be

⁸¹² See part IV.B.3.b.v *supra*.

⁸¹³ See part II.A.2.a *supra*.

⁸¹⁴ See *supra* note 238.

⁸¹⁵ SIFMA/IIB Letter, *supra* note 37, at 21-22.

less. For example, the commenter noted that a direct participant's affiliate's credit risk is already part of the group-wide financial risks to which the Treasury CCP is exposed, and central clearing of inter-affiliate transactions is unlikely to meaningfully impact the risk profile.⁸¹⁶ As discussed above, in certain circumstances, the counterparty credit risk posed by inter-affiliate transactions may be less than other transactions.⁸¹⁷ However, affiliated entities are separate legal entities and, generally, are not legally responsible for each other's contractual obligations therefore while there may be a benefit of reducing counterparty credit risk by centrally clearing such transactions, the benefit is likely to be less.

In additional changes from the proposal and for the reasons discussed above, the Commission is adding additional exclusions to the definition of an eligible secondary market transaction for any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a state or local government, a covered clearing agency providing central counterparty services, a derivatives clearing organization (*see* 7 U.S.C. 7a-1 and 17 CFR 39.3), or is regulated as a central counterparty in its home jurisdiction.⁸¹⁸ In the absence of the exclusion, these types of entities may not be able to transact with netting members of a CCA, reducing the available counterparties with which they could transact and likely resulting in adverse impacts on the prices that are available to them.

The amendment to Rule 17ad-22(e)(18) will increase the fraction of secondary market U.S. Treasury securities transactions required to be submitted for clearing at a covered clearing agency. The Commission believes that this should result in achieving the benefits associated with an increased level of central clearing discussed in this section.

⁸¹⁶ *Id.*

⁸¹⁷ *See supra* note 239.

⁸¹⁸ *See* part II.A.2.a *supra*.

i. Scope of the Requirement to Clear Eligible Secondary Market Transactions

A significant share of both cash and repo transactions in U.S. Treasury securities, including those of direct participants in a covered clearing agency, are not currently centrally cleared.⁸¹⁹ The Commission believes that covered clearing agency members not centrally clearing cash or repo transactions in U.S. Treasury securities create contagion risk to CCAs clearing and settling such transactions, as well as to the market as a whole, and that this contagion risk can be ameliorated by centrally clearing such transactions.

Currently, FICC, the only U.S. Treasury securities CCA, requires its direct participants to submit for central clearing their cash and repo transactions in U.S. Treasury securities with other members.⁸²⁰ However, FICC's rules do not require its direct participants, such as IDBs, to submit either cash or repo transactions⁸²¹ with persons who are not FICC members for central clearing.

The expanded scope of the requirement to clear eligible secondary market transactions should reduce instances of “hybrid” clearing, where FICC lacks visibility on the bilaterally cleared component of a trade. As discussed in the Proposing Release, trades cleared and settled outside of a CCP may not be subject to the same level of risk management associated with central clearing, which includes requirements for margin determined by a publicly disclosed method that applies objectively and uniformly to all members of the CCP, loss mutualization, and liquidity risk

⁸¹⁹ See DTCC May 2021 White Paper, *supra* note 307, at 5; 2021 IAWG Report, *supra* note 4, at 6.

⁸²⁰ FICC Rule 2A, section 7(e) (requirement that FICC Netting Members submit to FICC all of their eligible trades with other Netting Members); FICC Rule 18, section 2 (similar requirement with regard to Repo transactions); *cf.* FICC Rule 3, section 8(e) (providing clearing requirement for FICC IDB Members), *supra* note 19.

⁸²¹ With regard to Sponsored GC Repos, as noted above, these transactions can be secured with generic CUSIPs that include U.S. Treasury securities, and with other generic CUSIPs that include other securities, such as agency securities and mortgage backed securities. Because the requirement to clear eligible secondary market transactions is limited to eligible secondary market transactions in U.S. Treasury securities, it would not apply to Sponsored GC Repo generic CUSIPs that do not include U.S. Treasury securities.

management.⁸²² The requirement to clear eligible secondary market transactions should not only result in the consistent and transparent application of risk management requirements to trades that are now bilaterally cleared but also increase the CCA's awareness of those trades, which it now lacks.⁸²³

The definition of an eligible secondary market transaction applies to all types of transactions that are of a type currently accepted for clearing at a U.S. Treasury securities CCA; it does not impose a requirement on a U.S. Treasury securities CCA to offer additional products for clearing. One commenter specifically agreed that the proposal should apply to the types of transactions that are eligible for clearing at a U.S. Treasury securities CCA, as those eligibility criteria evolve over time. The commenter stated that such an approach would ensure that the requirement would not inadvertently give rise to risk or undue costs by forcing into central clearing transaction types that have not gone through a methodical risk analysis or for which the costs may outweigh the benefits, while at the same time, it would allow the requirement to evolve as U.S. Treasury securities CCAs, their direct participants, and regulators identify transaction types that would benefit from central clearing.⁸²⁴

ii. Application of the Requirement to Clear Eligible Repo Transactions

The requirement to clear eligible secondary market transactions requires that all direct participants of a U.S. Treasury securities CCA submit for clearing all eligible secondary market transactions that are repurchase agreements or reverse repurchase agreements. As discussed in part IV.B.5 *supra*, risk management practices in the bilateral clearance and settlement of repos are not uniform across market participants and are less transparent than analogous practices under

⁸²² See *supra* note 14, 87 FR at 64616; 2021 IAWG Report, *supra* note 4, at 30; G-30 Report, *supra* note 5.

⁸²³ See *supra* note 369.

⁸²⁴ DTCC/FICC Letter, *supra* note 33, at 12-13.

central clearing.⁸²⁵ Many commenters supported the definition of an eligible secondary market transaction as it relates to repo and reverse repo transactions.⁸²⁶ These commenters encouraged a broad and comprehensive definition to limit market fragmentation and avoidance of central clearing.

The benefits of central clearing – including the benefits of netting – increase with the fraction of total volume of similar transactions submitting for clearing at a CCP. Significant gaps persist in the current coverage of transaction data in U.S. Treasury repo.⁸²⁷ The Commission understands that, among bilaterally settled repo, approximately half was centrally cleared as of 2021.⁸²⁸ Centrally cleared triparty repo is a relatively new service, and the proportion may be smaller. Thus, despite the volume of centrally cleared repo transactions as seen in Figure 10 above, and the development of services to encompass more types of repo transactions at FICC, the Commission understands the volume of repo not currently centrally cleared to be substantial. The requirement that all U.S. Treasury CCA members submit all eligible repurchase agreements for central clearing would increase the fraction of total volume of such transactions submitted for central clearing, realizing the benefits described above in this section. In addition, because repo participants tend to be sophisticated market players, the requirement for repo transactions will

⁸²⁵ TMPG Repo White Paper, *supra* note 75, at 1.

⁸²⁶ See *supra* note 81.

⁸²⁷ 2021 IAWG Report, *supra* note 4, at 29. Some of the benefits discussed here may be mitigated if central clearing of repo were to occur at multiple CCPs (*e.g.*, in there was an additional registered clearing agency that accepted repo for clearing and in the absence of an agreement between those registered clearing agencies, the netting benefits may be less than those if there were but a single clearing agency accepting repo for clearing).

⁸²⁸ *Id.* (“Non-centrally cleared bilateral repo represents a significant portion of the Treasury market, roughly equal in size to centrally cleared repo.”) (citing a 2015 pilot program by the U.S. Treasury Department); see also TMPG Repo White Paper, *supra* note 804, at 1; Katy Burne, *Future-Proofing the U.S. Treasury Market*, BNY MELLON AERIAL VIEW 7 (2021), available at <https://www.bnymellon.com/content/dam/bnymellon/documents/pdf/aerial-view/future-proofing-the-us-treasury-market.pdf.coredownload.pdf> (noting that 63% of repo transactions remain non-centrally cleared according to Office of Financial Research data as of Sept. 10, 2021).

cover a set of market participants many of whom will have built most of the necessary processes and infrastructure to comply with the rule.

One commenter noted an additional potential benefit to money market funds (“MMFs”).⁸²⁹ The commenter stated that MMFs are only permitted to execute repo transactions with counterparties that are rated by one of the top rating agencies, a benefit typically accessible to only larger participants due to the prohibitive cost of obtaining and maintaining a rating from the top tier rating agencies. The commenter stated that this limits the number of potential counterparties with which MMFs can execute repo transactions, limiting liquidity and pricing options available to the MMFs. If MMFs are able to transact as sponsored members whose trades are centrally cleared and are able to look through the initial counterparty to the credit worthiness of the CCP itself, liquidity and pricing available to MMFs is likely to improve.

Some commenters questioned the need for a requirement with respect to repo, noting that the balance sheet netting efficiencies already exist, providing a natural incentive to centrally clear such transactions.⁸³⁰ The Commission agrees that centrally cleared repo already benefits from favorable treatment on balance sheet, but believes that a requirement to clear repo transactions would result in more transactions being centrally cleared and, accordingly, additional balance sheet efficiency and capacity to intermediate repo transactions.⁸³¹ Although FICC netting members may wish to increase the fraction of their repo business that is centrally cleared in order to take greater advantage of netting efficiencies, they are only able to do so to the extent that their counterparties

⁸²⁹ Letter from the Independent Dealer & Trader Association, at 10-11 (Sept. 1, 2023) (“IDTA Letter 2”).

⁸³⁰ See *supra* note 84.

⁸³¹ Duffie *supra* note 718, provides empirical evidence with supporting theory that the current intermediation capacity of the U.S. Treasury market impairs its resilience. Among the improvements he discusses that could increase the market’s intermediation capacity under stress is broader central clearing. See *Resilience redux in the US Treasury market*, *supra* note 718. See also *Dealer Capacity and US Treasury*, presentation to SEC Staff (July 2023), *supra* note 702.

have taken the steps necessary to access clearing. Requiring most repo transactions with a FICC netting member on one side to be centrally cleared assures that counterparties will have taken such steps. Thus, there would still be benefits from the requirement, despite the currently existing balance sheet treatment.

The OFR published a 2023 report on an OFR pilot data collection of non-centrally cleared bilateral repurchase agreement (“NCCBR”) trades spanning nine dealers over three reporting dates in June 2022.⁸³² Of the four bilateral repo segments discussed (centrally cleared transactions settled on the triparty platform, centrally cleared transactions using the FICC DVP service, non-centrally cleared transactions settled on the triparty platform, and NCCBR transactions), the NCCBR segment is the largest of the four segments of the repo market in terms of gross repo exposure by primary dealers.⁸³³ The OFR’s report uses the pilot data collection to answer the question of why volume in this segment is so high despite the benefits of central clearing, including the ability of dealers to net their repo positions with one counterparty against reverse repo positions with another counterparty for the purpose of calculating certain regulatory ratios, thus reducing the balance sheet costs of participating in repo. The report’s authors estimate that over 60% of all Treasury trades in the NCCBR market are naturally netted (matching repo and reverse repo with the same counterparty and tenor, typically as part of a relative value trade); however, they also show that substantial balance sheet netting benefits could still result from the trades that are not naturally netted if NCCBR trades were moved into central clearing.⁸³⁴

⁸³² See Hempel et al. (2023), *supra* note 564.

⁸³³ *Id.*

⁸³⁴ *Id.*

Several commenters recommended excluding triparty repos from the definition of an eligible secondary market transaction.⁸³⁵ Four of these commenters suggested that the cost of including triparty repos would outweigh the benefits.⁸³⁶ Several commenters argued that including triparty repos would not significantly reduce the risks that the proposal seeks to address because the current triparty market infrastructure inherently mitigates the associated risks.⁸³⁷ Specifically, these commenters argue that credit risk in the triparty market is mitigated by the triparty agent’s provision of custodial, collateral management, and settlement services.⁸³⁸ Moreover, one commenter stated that the infrastructure underlying the triparty repo market is robust and provides credit protections, operational safeguards, and strict internal controls akin to central clearing.⁸³⁹ One commenter added that the triparty market is relatively safe from credit risk because the triparty agent is subject to prudential regulation.⁸⁴⁰ One commenter added that settlement risk in the triparty market is nearly eliminated because collateral posted to the triparty platform cannot generally be repledged outside the platform.⁸⁴¹ The commenter stated, therefore, that the only significant source of settlement risk is the rare occurrence of a counterparty’s nonpayment of the repurchase price, which is generally attributable to operational risk as opposed to credit risk.⁸⁴²

Despite supporting the exclusion of triparty repos from the definition of an eligible secondary market transaction, one commenter acknowledged that the triparty agent “does not

⁸³⁵ See *supra* note 85.

⁸³⁶ See MFA Letter, *supra* note 81, at 6, 14; SIFMA/IIB Letter, *supra* note 37, at 20; ICI Letter, *supra* note 85, at 11; Federated Letter, *supra* note 85, at 5.

⁸³⁷ See MFA Letter, *supra* note 81, at 14; SIFMA/AMG Letter, *supra* note 35, at 11; ICI Letter, *supra* note 85, at 12, 22; Citadel Letter, *supra* note 81, at 6; Federated Letter, *supra* note 85, at 5.

⁸³⁸ See *id.*

⁸³⁹ See ICI Letter, *supra* note 85, at 22.

⁸⁴⁰ See MFA Letter, *supra* note 81, at 14.

⁸⁴¹ See Federated Letter, *supra* note 85, at 5.

⁸⁴² See Federated Letter, *supra* note 85, at 5.

fulfill a CCP role—it does not guarantee either counterparty’s performance through novation or otherwise and does not assume counterparty risk.”⁸⁴³ The Commission recognizes that the current triparty market infrastructure incorporates credit protections, operational safeguards, and strict internal controls. However, as discussed above, the triparty agent does not fulfill a CCP role, and therefore, the Commission disagrees with the contention that the current market infrastructure incorporates controls akin to those available through central clearing.⁸⁴⁴ Therefore, the benefits accruing to additional central clearing using a U.S. Treasury securities CCA apply in varying degree to triparty transactions as well.⁸⁴⁵

In response to the commenter who stated that most risks are eliminated because collateral cannot be posted outside the triparty platform, the Commission disagrees. For example, significant risks exist if concerns emerge regarding the financial condition of borrowers in the triparty market.⁸⁴⁶ In such scenarios, even though collateral stays within the triparty platform, the repo buyer could still face the sudden default of a triparty repo counterparty.⁸⁴⁷ Moreover, the Commission understands that settlement failures occur regularly and tend to spike during market stress events.⁸⁴⁸ Even though not considered a default, settlement failures create credit exposure to

⁸⁴³ ICI Letter, *supra* note 85, at 33.

⁸⁴⁴ *See supra* part II.A.2.a *supra*.

⁸⁴⁵ *Id.*

⁸⁴⁶ *See* 2013 Annual Report of the Financial Stability Oversight Council, at 4, 12-13, 133-134, *available at* <https://home.treasury.gov/system/files/261/FSOC-2013-Annual-Report.pdf>; Begalle et al., *supra* note 98 (discussing concern that stress caused by a potential default of a triparty repo counterparty can lead to either pre-default fire sales of assets by the counterparty or post-default fire sales of collateral by the triparty repo investor and the related financial stability concerns).

⁸⁴⁷ *See* SEC Division of Investment Management Guidance Update: Counterparty Risk Management Practices with Respect to Tri-Party Repurchase Agreements (July 2013), *available at* <https://www.sec.gov/divisions/investment/guidance/im-guidance-2013-03.pdf>.

⁸⁴⁸ *See e.g.*, Adam Copeland, Antoine Martin, Michael Walker, Repo Runs: Evidence from the Tri-Party Repo Market, N.Y. Fed Staff Report No. 506, at 26-30, *available at* https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr506.pdf; Tobias Adrian,

the failing counterparty and market risk exposure with respect to the relevant Treasuries.⁸⁴⁹

Furthermore, settlement failures may prevent or make more costly the non-failing party's delivery of the relevant Treasuries in respect of other transactions.

One commenter stated that the Commission must address other aspects of the Sponsored Service to better promote the objectives of central clearing, with such issues including the treatment of the start leg of the transaction, FICC's obligations to complete settlement of a Sponsored Member's positions in the event of a Sponsoring Member's default, and a Sponsored Member's ability to engage with FICC to address issues arising from repo transactions that have been submitted through sponsored clearing.⁸⁵⁰ The commenter stated that, within the Sponsored Service, FICC does not novate the settlement of the start leg of a repo transaction that is submitted for clearing between a sponsoring Member and a sponsored Member, although it does novate the end leg of the transaction, meaning that the counterparties continue to be responsible for settlement outside of FICC and bear the risk of a settlement fail vis a vis one another. The commenter also states that the lack of central clearing for the start leg of repo transactions in the Sponsored Service means that a requirement to clear eligible secondary market transactions may not eliminate counterparty credit risk issues to the extent the Commission anticipates, which, in turn, means that the proposal may not increase competition or reduce spreads as the Commission predicted in the Proposing Release.

Christopher R. Burke, and James J. McAndrews, *The Federal Reserve's Primary Dealer Credit Facility*, 15 Fed. Res. Bank N.Y. Current Issues in Econ. and Fin. 4, available at https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci15-4.pdf; see also Michael Fleming & Kenneth Garbade, *Explaining Settlement Fails*, 11 Fed. Res. Bank N.Y. Current Issues in Econ. and Fin. 1 (Sept. 2005), available at https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci11-9.pdf.

⁸⁴⁹ See Treasury Market Practice Group, *U.S. Treasury Securities Fails Charge Trading Practice* (July 27, 2018), available at <https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/TMPG-UST-fails-charge-trading-practice-FINAL-07-27-18.pdf>.

⁸⁵⁰ ICI Letter, *supra* note 85, at 26-28.

The Commission understands that, contrary to transactions cleared at FICC outside the Sponsored Service, FICC currently does not novate the start legs of same-day settling Sponsored DVP Repos where the Sponsored Member's pre-novation counterparty is its Sponsoring Member (*i.e.*, "done-with" Sponsored DVP Repo) or of Sponsored GC Repos. However, the Commission does not believe that this failure to novate is inconsistent with the definition of an eligible secondary market transaction being adopted in this release.⁸⁵¹ The Commission acknowledges that settlement of the start leg occurring outside central clearing could somewhat reduce the benefits of central clearing in this limited instance, but the counterparty credit risk arising from the start legs of such transactions are largely addressed by the fact that they usually settle on a delivery-versus-payment basis between the counterparties, meaning that the securities and funds are exchanged simultaneously and resulting in less counterparty credit risk to address. However, the Commission further understands that FICC has stated that it is able to clear the start leg of any repo and currently does clear the start leg of all repos between two direct participants, the start leg of any Sponsored DVP repo where the Sponsored Member's pre-novation counterparty is a third-party member of FICC (*i.e.*, "done-away" from the Sponsoring Member), and any Sponsored DVP Repo where the start leg of such repo is scheduled to settle on some business day in the future (*i.e.*, forward-settling repos).⁸⁵²

One commenter stated that neither the Sponsored Bilateral DVP Service nor the Sponsored GC Repo Service compel FICC to complete the settlement of a sponsored member's transactions in the event of a sponsoring member's default, and that this approach is not consistent with the

⁸⁵¹ See Part II.C.2.c, *supra*.

⁸⁵² See FICC Rule 11, section 2, *supra* note 19; FICC Buyside FAQ, *supra* note 169, at 2-3.

Commission's assumption that central clearing increases the likelihood of settlement.⁸⁵³ The Commission understands that this ability to, potentially, terminate the Sponsored Member's transaction in such circumstances arises from the fact that, within the Sponsored Service, by design, the Sponsoring Member serves as the processing agent for all movement of funds and securities for its Sponsored Members, and FICC is not able to guarantee that an insolvent Sponsoring Member, which may be subject to the control of another legal entity, such as a bankruptcy trustee, would be able to continue processing such transactions. This aspect of FICC's rules is consistent with how other central counterparties have addressed the potential termination of customer transactions in the event of their agent's default.⁸⁵⁴ As discussed in Part II.B.2.c *supra*, the Commission does not believe that the potential for FICC to terminate these transactions, in the unlikely event of a Sponsoring Member default in which it is unable to work with the controlling legal entity, means that the benefits in the Proposing Release would not be, to a great extent, realized.

iii. Application of the Requirement to Clear Eligible Secondary Market Transactions to Purchases and Sales of U.S. Treasury Securities

As discussed above, 68 percent of cash market transactions in U.S. Treasury securities are not centrally cleared, and another 19 percent of such transactions are subject to so-called hybrid clearing.⁸⁵⁵ The Commission has identified certain categories of purchases and sales of U.S. Treasury securities that it believes should be part of the requirement to clear eligible secondary market transactions, *i.e.*, for which U.S. Treasury securities CCAs are obligated to impose

⁸⁵³ ICI Letter, *supra* note 85, at 27.

⁸⁵⁴ See *supra* note 438 and referencing paragraph.

⁸⁵⁵ Proposing Release, *supra* note 14, at 64613.

membership rules to require clearing of such transactions. The benefits of including these categories are described below.

As with repurchase transactions, the general benefits of central clearing discussed in part IV.A *supra* become greater as the fraction of total transaction volume that is centrally cleared increases. In other words, there are positive externalities associated with broader central clearing. However, unlike in the repo market, the Commission is not requiring that all cash market transactions completed with a FICC member be centrally cleared.⁸⁵⁶

Several commenters suggested that the scope of eligible secondary market transactions in the cash market be broadened. One commenter stated that the Commission should align the scope of the definition with respect to cash transactions with the proposed scope for repos, subject to certain limited exceptions for investors that trade de minimis volumes. The commenter argued that the Commission's approach with respect to cash transactions will increase costs for a specific subset of market participants, thereby putting them at a competitive disadvantage, while failing to deliver the envisaged market-wide benefits associated with central clearing (*i.e.*, it would materially reduce the associated multilateral netting benefits, impair the risk management practices of clearing agencies, and hinder the evolution in trading protocols that can be expected from a market-wide clearing requirement).⁸⁵⁷ For similar reasons, another commenter also stated that the benefits of central clearing detailed "will only materialize if a market-wide mandate is implemented" and supported defining the scope of eligible secondary market transactions for cash

⁸⁵⁶ The G-30 report recommends an approach to clearing all of repo, and some cash trades. *See generally* G-30 Report, *supra* note 5.

⁸⁵⁷ Citadel Letter, *supra* note 81, at 5.

transactions as broadly as that proposed for repos.⁸⁵⁸ Another commenter stated that limiting the scope of the cash clearing mandate would result in unwarranted competitive disadvantages and related market distortions for some types of investors, such as hedge funds, or some types of trading platforms, such as anonymous trading facilities.⁸⁵⁹

The Commission proposed a targeted approach to clearing in the cash market in the Proposing Release, limiting the clearing requirement to specific types of entities transacting with members of a U.S. Treasury securities CCA that pose certain risks when clearing cash market treasury transactions bilaterally.⁸⁶⁰ As discussed in the Proposing Release and discussed in part II.2.b *supra*, the Commission believed that including within the scope of eligible transactions the cash transactions of levered funds and hedge funds is more important than those of other market participants that were not included in part because the strategies employed by hedge funds “can increase the likelihood that the fund will experience stress or fail, and amplify the effects on financial markets.”⁸⁶¹ The Commission is not including purchases and sales of U.S. Treasury securities between a direct participant and either a hedge fund or a levered account within the definition of an eligible secondary market transaction in light of questions raised by commenters regarding the inclusion of a hedge fund and a leveraged account as proposed that merit further

⁸⁵⁸ ARB et al. Letter, *supra* note 81, at 4 (stating that the netting benefits associated with transitioning only proprietary trading firm (“PTF”) transactions into central clearing are much smaller, given the substantial netting that already occurs directly with inter-dealer brokers (“IDBs”); the trading-related benefits of central clearing will only accrue to market participants if their transactions are covered by the proposed mandate; and that clearing agency resiliency will be negatively impacted if only one segment of the market is cleared).

⁸⁵⁹ MFA Letter, *supra* note 81, at 2.

⁸⁶⁰ See part II.A.2.b *supra* for discussion of the justification for the scope as proposed.

⁸⁶¹ Proposing Release, *supra* note 14 at 64623-4.

consideration, and the Commission will continue to evaluate the issues raised to determine if any further action is appropriate.⁸⁶²

In response to the comment that characterized a market-wide mandate as a “necessary condition” for adoption of any mandate, the Commission does not believe that all benefits of central clearing exist only if the entire market is centrally cleared. The increased clearing of cash transactions, targeted to address the differing risk profiles of each market segment, would still bring the benefits of central clearing to an important part of the cash market. As explained below, cash and repo markets differ in important ways that suggest a broader definition of eligible secondary market transactions for repo and a less broad definition for cash transactions. Though there are linkages across markets, segments of the Treasury market are distinct, and for this reason, the Commission addresses the risks in each of these categories separately in parts II.A.2.b.ii through iii *supra*.

The Commission understands the set of participants in U.S. Treasury securities cash markets to be far broader and more heterogeneous than in the repo markets. The cash market has many participants that trade in relatively small amounts, whereas the market for repo is dominated by larger, more sophisticated institutions. Although difficult to quantify precisely, the number of participants is one or more orders of magnitude greater in the cash market as compared with the repo market. Because the benefits increase with the number and size of transactions, whereas the costs have a large fixed component, extending the clearing mandate to institutions that are market participants in repo markets and a subset of the institutions that are participants in cash markets should capture a large fraction of market activity, while also capturing the most active market

⁸⁶² See part II.A.2.b.i *supra*.

participants who may already have some ability to connect with the clearing agency and experience with central clearing.

a. IDB Transactions

The amendments being adopted require that all purchases and sales of U.S. Treasury securities entered into by a direct participant of a U.S. Treasury securities CCA and any counterparty, if the direct participant of the CCA brings together multiple buyers and sellers using a trading facility (such as a limit order book) and serves as a counterparty to both the purchaser and seller in two separate transactions executed on its platform, be subject to the requirement to centrally clear eligible secondary market transactions. This requirement encompasses the transactions of those entities serving as IDBs in the U.S. Treasury securities market, in that it covers entities that are standing in the middle of transactions between two counterparties that execute a trade on the IDB's platform.⁸⁶³

The amendments being adopted will result in more central clearing of IDB trades. FICC Member IDBs do not take directional positions on the securities that trade on the IDB's platform. Consequently, a requirement that FICC member IDBs centrally clear all of their trades will give FICC better insight into the risk position of its clearing members through the elimination of the hybrid clearing transactions mentioned above.

In contrast to other FICC members, FICC members that are also IDBs will be required to centrally clear all of their cash trades (and repo, as described above). As described in the TMPG White Paper and in the recent G-30 report,⁸⁶⁴ IDBs act as central nodes in the system, in effect serving as clearing agencies without the regulatory structure of clearing agency. Furthermore, the

⁸⁶³ See Proposing Release, *supra* note 14, at 64616 for further discussion of IDBs and their role in the cash market for U.S. Treasury securities.

⁸⁶⁴ See generally G-30 Report, *supra* note 5.

netting benefits to IDBs, as described in this section are likely to be particularly high, because each transaction on an IDB is matched by a transaction on the other side. IDBs are sophisticated institutions that have experience managing the central clearing of trades as they already centrally clear all trades with other FICC members.

The configuration of counterparty risk presented by hybrid clearing allows FICC to manage the risks arising from the IDB-FICC member trade, but FICC cannot manage the risks arising from the IDB's offsetting trade with its non-FICC member counterparty and the potential counterparty credit risk and settlement risk arising to the IDB from that trade.⁸⁶⁵ Thus, the IDB is not able to net all of its positions for clearing at FICC, and the IDB's positions appear to FICC to be directional, which impacts the amount of margin that FICC collects for the visible leg of the "hybrid" transaction. This lack of visibility can increase risk during stress events, when margin requirements usually increase. Thus, FICC is indirectly exposed to the IDB's non-centrally cleared leg of the hybrid clearing transaction, but it lacks the information to understand and manage its indirect exposure to this transaction. As a result, in the event that the non-FICC counterparty were to default to the IDB, causing stress to the IDB, that stress to the IDB could be transmitted to the CCP and potentially to the system as a whole.⁸⁶⁶ In particular, if the IDB's non-FICC counterparty fails to settle a transaction that is subject to hybrid clearing, such an IDB may not be able to settle the corresponding transaction that has been cleared with FICC, which could lead the IDB to default. As part of its existing default management procedures, FICC could seek

⁸⁶⁵ See, e.g., TMPG White Paper, *supra* note 13, at 22 (noting that in a hybrid clearing arrangement, an "IDB's rights and obligations towards the CCP are not offset and therefore the IDB is not in a net zero settlement position with respect to the CCP at settlement date.").

⁸⁶⁶ See DTCC May 2021 White Paper, *supra* note 307, at 5.

to mutualize its losses from the IDB's default, which could in turn transmit stress to the market as a whole.

The Commission has previously stated that membership requirements help to guard against defaults of any CCP member, as well to protect the CCP and the financial system as a whole from the risk that one member's default could cause others to default, potentially including the CCP itself.⁸⁶⁷ Further, contagion stemming from a CCP member default could be problematic for the system as a whole, even if the health of the CCP is not implicated. This is so because the default could cause others to back away from participating in the market. This risk of decreased market participation could be particularly acute if the defaulting participant were an IDB, whose withdrawal from the market could jeopardize other market participants' ability to access the market for on-the-run U.S. Treasury securities.⁸⁶⁸ And because IDBs facilitate a significant proportion of trading in on-the-run U.S. Treasury securities (that is, they form central nodes), such a withdrawal could have significant consequences for the market as a whole.⁸⁶⁹ The requirement to clear eligible secondary market transactions should therefore help mitigate this risk by mandating that a U.S. Treasury securities CCA ensure its IDB members clear both sides of their transactions, thereby eliminating the various facets of potential contagion risk posed by so-called hybrid clearing.

Commenters generally supported the inclusion of IDB transactions in the definition of an eligible secondary market transaction.⁸⁷⁰ Another commenter, although not supporting a requirement to clear repos, stated that if such a requirement was adopted it should be limited to

⁸⁶⁷ See CCA Standards Proposing Release, *supra* note 8.

⁸⁶⁸ TMPG White Paper, *supra* note 13, at 32.

⁸⁶⁹ See *id.*

⁸⁷⁰ See AIMA Letter, *supra* note 81, at 7.

IDBs and broker-dealers because (1) the counterparties to such transactions are the most active participants in the Treasury repo markets, thereby allowing the Commission to meaningfully increase central clearing without applying a more categorical requirement, and (2) because such transactions are more interconnected with the rest of the market and have a higher possibility to transfer risk to outside parties (including potentially a U.S. Treasury securities CCA).⁸⁷¹

However, certain commenters asserted that this aspect of the definition would inappropriately disadvantage IDBs, with uncertain benefits and potentially significant negative consequences that would result if market participants shifted their trading activity away from IDBs.⁸⁷² Three commenters expressed concerns that including IDB transactions in the definition of an eligible secondary market transaction could draw trading activity away from IDBs, thereby reducing market liquidity and market stability.⁸⁷³ The commenters also noted that IDBs are anonymous platforms that currently support all-to-all trading, which the Commission has recognized would improve market structure and stability.⁸⁷⁴ The commenters argued that including IDB transactions in the definition of an eligible secondary market transaction could, therefore, hinder all-to-all trading.⁸⁷⁵ One of these commenters further argued that by discouraging market participants from trading on IDBs, the requirement to clear eligible secondary market transactions, as drafted, could limit the choices of market participants with respect to trading venues.⁸⁷⁶

⁸⁷¹ See SIFMA/IIB Letter, *supra* note 37, at 19-20.

⁸⁷² See ICI Letter, *supra* note 85, at 3, 11; MFA Letter, *supra* note 81, at 19-21; *see also* Tradeweb Letter, *supra* note 81, at 3-4.

⁸⁷³ See ICI Letter, *supra* note 85, at 3, 11; MFA Letter, *supra* note 81, at 20; Tradeweb Letter, *supra* note 81, at 3-4.

⁸⁷⁴ *See id.*

⁸⁷⁵ *See id.*

⁸⁷⁶ See MFA Letter, *supra* note 81, at 20.

The Commission disagrees with these commenters. The inclusion of IDB transactions, along with other types of transactions, would not necessarily lead to decreased liquidity and market stability or negatively impact all-to-all trading in the U.S. Treasury market. The benefits to market participants from trading on an IDBs, that is the ability find counterparties and to trade anonymously are significant and will continue even if such transactions are eligible secondary market transactions, meaning that such transactions would incur the costs associated with central clearing and described below.

Moreover, even in the event that some of these concerns materialize from the inclusion of IDB transactions, the inclusion of IDB transactions is justified as it would allow the U.S. Treasury securities CCA to better risk manage “hybrid” transactions that are currently not being submitted for central clearing. Specifically, including IDB transactions in the definition of an eligible secondary market transaction would address the potential for contagion risk associated with hybrid clearing. As explained in the Proposing Release, the configuration of counterparty risk presented by hybrid clearing allows the U.S. Treasury securities CCA to manage the risks arising from the IDB-CCA direct participant transaction, on the one hand, but the U.S. Treasury securities CCA cannot manage the risks arising from the IDB’s offsetting transaction with its non-member counterparty and the potential counterparty credit risk and settlement risk arising to the IDB from that trade.⁸⁷⁷ Thus, under the current hybrid clearing model, the U.S. Treasury securities CCA is indirectly exposed to the IDB’s non-centrally cleared transaction, but it lacks the ability to risk manage its indirect exposure to this non-centrally cleared leg of the transaction. Specifically, it

⁸⁷⁷ See, e.g., TMPG White Paper, *supra* note 13, at 22 (noting that in a hybrid clearing arrangement, an IDB’s rights and obligations to the CCP are not offset and the IDB is not in a net zero settlement position with respect to the CCP at settlement date). Thus, the IDB is not able to net all of its positions for clearing at a U.S. Treasury securities CCA, and the IDB’s positions appear to the CCA to be directional, which impacts the amount of margin that the CCA collects for the transaction.

does not know who the ultimate counterparty of the transaction is and cannot collect margin on that transaction. This, in turn, results in margin collection at the CCP which is based upon only one transaction and has been calculated to cover this seemingly directional position, as well as an inability to net these offsetting transactions and provide the benefits of central clearing. In particular, if the IDB's non-CCP member counterparty fails to settle a transaction that is subject to hybrid clearing, such IDB may not be able to settle the corresponding transaction that has been cleared with the U.S. Treasury securities CCA due to a lack of financial resources at the IDB, which could lead the IDB to default.⁸⁷⁸ As part of its existing default management procedures, the U.S. Treasury securities CCA could seek to mutualize its losses from the IDB's default, which could in turn transmit stress to the market as a whole.

As noted above, the Commission has previously stated that membership requirements help to guard against defaults of any CCP member, as well as to protect the CCP and the financial system as a whole from the risk that one member's default could cause others to default, potentially including the CCP itself.⁸⁷⁹ Further, contagion stemming from a CCP member default could undermine confidence in the financial system as a whole, even if the health of the CCP is not implicated. This is because the default could cause others to back away from participating in the market. This risk of decreased participation could be particularly problematic if the defaulting participant was an IDB, whose withdrawal from the market could impact other market participants' ability to access the market for on-the-run U.S. Treasury securities, approximately 49.7% of which trade on IDBs.⁸⁸⁰ Including such transactions as eligible secondary market transactions would therefore help protect against this risk by requiring that a U.S. Treasury

⁸⁷⁸ See 2021 IAWG Report, *supra* note 4, at 31; See also DTCC May 2021 White Paper, *supra* note 307.

⁸⁷⁹ See *supra* note 308.

⁸⁸⁰ TMPG White Paper, *supra* note 13, at 32; part IV.B.3 (Table 1) *supra*.

securities CCA ensure that direct participants who are IDBs centrally clear both sides of their transactions, thereby eliminating the various aspects of potential contagion risk posed by so-called hybrid clearing.

b. Other Cash Transactions

The Commission has identified additional categories of cash transactions of U.S. Treasury securities to include in the membership requirements for a U.S. Treasury securities CCA that it believes will provide the benefits of increased central clearing of U.S. Treasury securities transactions described above.

The Commission is defining an eligible secondary market transaction to include those cash purchase and sale transactions in which the counterparty of the direct participant is a registered broker-dealer, government securities broker, or dealer.⁸⁸¹ These entities, by definition, are engaged in the business of effecting transactions in securities for the account of others (for brokers) or for their own accounts (for dealers). Thus, these entities already are participating in securities markets and have identified mechanisms to clear and settle their transactions.⁸⁸² More generally, many registered brokers and dealers are familiar with transacting through introducing brokers who pass their transactions to clearing brokers for clearing and settlement.

In the Proposing Release, the Commission proposed to include in the definition of eligible secondary market transaction any purchases and sales of U.S. Treasury securities between a direct participant and a counterparty that is: (i) a hedge fund, that is any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking

⁸⁸¹ 15 U.S.C. 78o(a) and 78o-5(a) (requirement to register) and 78c(4), (5), (43), and (44) (definitions).

⁸⁸² *See, e.g.*, FICC Rules 3A, 8, 18, *supra* note 663 (providing for prime brokerage and correspondent clearing and sponsored membership); *see also* October 2021 White Paper, *supra* note 681, at 5-7.

into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration) (“hedge fund transactions”), or (ii) an account at a registered broker-dealer, government securities dealer, or government securities broker where such account may borrow an amount in excess of one-half of the value of the account or may have gross notional exposure of the transactions in the account that is more than twice the value of the account (“leveraged account transactions”).⁸⁸³

Some commenters supported the proposed inclusion of transactions with hedge funds within the definition of an eligible secondary market transaction.⁸⁸⁴ However, other commenters asserted that transactions with a hedge fund should not be within the definition of an eligible secondary market transaction. Specifically, one commenter stated that because of the nature of the definition, eligible secondary market transactions would include those with firms that may (but in practice might not actually) exceed the quantitative thresholds without regard to the risks that these firms actually take on, or their investment models and strategies. Further, the commenter stated that the definition would not reflect any effort to assess whether any particular fund or account actually imposes systemic risk, and would instead treat the mere ability to obtain leverage as a source of risk.⁸⁸⁵ Another commenter stated that there is no data to support imposing a clearing

⁸⁸³ See part II.A.2.b *supra*.

⁸⁸⁴ See DTCC/FICC Letter, *supra* note 33; Better Markets Letter, *supra* note 33; AFREF Letter, *supra* note 33.

⁸⁸⁵ See MFA Letter, *supra* note 81 at 19-20.

requirement that targets just hedge funds and leveraged accounts and expressed concern that a partial mandate may result in some dealers choosing to offer liquidity only in a cleared environment thereby reducing the liquidity available today to accounts in the uncleared cash market.⁸⁸⁶ Another commenter stated that the inclusion of hedge funds within the counterparties to an eligible secondary market transaction would arbitrarily single out hedge funds' cash Treasury transactions and would leave out other important market participants' cash Treasury transactions that also comprise a large segment of Treasury market liquidity.⁸⁸⁷

As the Commission stated in the Proposing Release, hedge funds generally can engage in trading strategies that may pose heightened risks of potential financial distress to their counterparties, including those who are direct participants of a U.S. Treasury securities CCA. The Commission previously has recognized that the strategies employed by hedge funds “can increase the likelihood that the fund will experience stress or fail, and amplify the effects on financial markets.”⁸⁸⁸ The Commission also has stated that significant hedge fund failures, resulting from their investment positions or use of leverage or both, could result in material losses at the financial institutions that lend to them if collateral securing this lending is inadequate, and that these losses could have systemic implications if they require these financial institutions to scale back their lending efforts or other financing activities generally.⁸⁸⁹

⁸⁸⁶ See SIFMA AMG Letter, *supra* note 35, at 11.

⁸⁸⁷ See AIMA Letter, *supra* note 81, at 7.

⁸⁸⁸ See Form PF Proposing Release, *supra* note 279, 76 FR at 8073 (citing President's Working Group on Financial Markets, Hedge Funds, Leverage, and the Lessons of Long Term Capital Management (Apr. 1999), at 23).

⁸⁸⁹ *Id.* (also noting that the simultaneous failure of several similarly positioned hedge funds could create contagion through the financial markets if the failing funds had to liquidate their investment positions at fire sale prices).

Similar to the risks posed to a U.S. Treasury securities CCA by non-centrally cleared trades entered into by an IDB, non-centrally cleared transactions entered into between hedge funds and direct participants of the CCA could cause risks to the CCA in the event that the hedge fund is not able to meet its obligations to the direct participant, which could, in turn, create stress to the direct participant and through to the CCA. Therefore, including the direct participant's purchase and sale transactions with hedge funds within the definition of an eligible secondary market transaction would have reduced the potential for financial distress arising from the transactions that could affect the direct participant and the U.S. Treasury securities CCA. This aspect of the proposal would also have resulted in consistent and transparent risk management being applied to such transactions, as discussed further in part II.A.2.a *supra*.

However, in response to comments received and as discussed in part II.A.2.b *supra*, the Commission is not adopting a definition of eligible secondary market transaction in Rule 17ad-22(a) that includes these transactions.⁸⁹⁰

iv. Exclusions from the Requirement to Clear Eligible Secondary Market Transactions

The Commission is excluding certain otherwise eligible secondary market transactions in U.S. Treasury securities from the requirement to clear eligible secondary market transactions. Recognizing the importance of U.S. Treasury securities not only to the financing of the United States government, but also their central role in the formulation and execution of monetary policy and other governmental functions, the Commission is excluding from the requirement to clear eligible secondary market transactions any otherwise eligible secondary market transaction in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a central

⁸⁹⁰ *Id.*

bank.⁸⁹¹ For similar reasons, the Commission is also excluding from the requirement to clear eligible secondary market transactions otherwise eligible secondary market transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a sovereign entity or an international financial institution.⁸⁹² In a change from the proposal, and for the reasons given above, the Commission is excluding from the requirement to clear eligible secondary market transactions otherwise eligible secondary market transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and either a state and local government or a covered clearing agency providing central counterparty services, a derivatives clearing organization (*see* 7 U.S.C. 7a-1 and 17 CFR 39.3), or is regulated as a central counterparty in its home jurisdiction.⁸⁹³

One commenter recommended that the Commission exempt transactions in U.S. Treasury securities between affiliates from any central clearing requirement. The commenter stated that inter-affiliate transactions are important to corporate groups, which may use them to achieve efficient risk and capital allocation and obtain flexibility for addressing customer demands.⁸⁹⁴ The commenter further stated that requiring inter-affiliate transactions to be centrally cleared would impose additional costs with limited benefits, for two reasons. First, if an inter-affiliate transaction is part of a “back-to-back arrangement,” meaning that the related external transaction between the affiliated counterparty and a non-affiliated counterparty is not centrally cleared, then subjecting the inter-affiliate transaction to a central clearing requirement does nothing to reduce the contagion risk presented by the non-affiliated counterparty. The commenter further asserted that if that

⁸⁹¹ See Proposing Release, *supra* note 14, at 64625 for a discussion of the proposed definition of a central bank for the purposes of the rule.

⁸⁹² See *id.* for a discussion of the proposed definition of sovereign entity and international financial institution.

⁸⁹³ See part II.A.2.a.vii *supra* and part II.A.2.a.iii *supra*.

⁸⁹⁴ SIFMA/IIB Letter, *supra* note 37, at 21-22.

external transaction is already centrally cleared, the contagion risk would already be addressed and requiring the inter-affiliate transaction to be cleared would not create additional benefits. Second, a direct participant's affiliate's credit risk is already part of the group-wide financial risks to which the Treasury CCP is exposed, and central clearing of inter-affiliate transactions is unlikely to meaningfully impact the risk profile.⁸⁹⁵

The Commission agrees and in a change from the proposing release, the Commission is conditionally excluding inter-affiliate repo.⁸⁹⁶ The Commission believes that, in certain circumstances, the counterparty credit risk posed by inter-affiliate transactions may be less than other transactions.⁸⁹⁷ However, the credit risk is not eliminated because affiliated entities are separate legal entities and, generally, are not legally responsible for each other's contractual obligations. In the event that one or more affiliated entities becomes insolvent, the affiliates, as separate legal entities, would be managed as separate estates in a bankruptcy, with the trustee having a duty to the creditors of the affiliate, not the affiliated family. Other benefits of increased central clearing such as consistent risk management and centralized default management are likely to be less important for transactions within an affiliated family. Therefore, the Commission believes the benefits of clearing such transactions are likely less than those from similar transactions with non-affiliates while the costs of doing so are likely similar.

⁸⁹⁵ *Id.*

⁸⁹⁶ See part II.A.2.a, *supra*. The Commission is conditioning the availability of the exclusion for inter-affiliate transactions on an obligation for the affiliated counterparty to submit its eligible repo transactions for clearance and settlement. This condition should help ensure that a direct participant cannot rely upon an inter-affiliate transaction to avoid the requirement to clear eligible secondary market transactions. If there were no such condition, a direct participant could simply use inter-affiliate transactions to move securities and funds to affiliates, and the affiliate could then enter into external transactions with counterparties which, if entered into with the direct participant, would be eligible secondary market transactions.

⁸⁹⁷ See, e.g., Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 FR 50425, 50427 (Mar. 2012) (discussing the internalization of counterparty risk on inter-affiliate swap transactions as wholly owned members of the same corporate group, but also discussing that similar benefits may not accrue for other inter-affiliate swaps when the counterparties are not members of the same group).

Although the Commission believes that the benefits of central clearing are generally increasing in the fraction of total volume that is centrally cleared, it also believes that the Federal Reserve System should be free to choose the clearance and settlement mechanisms that are most appropriate to effectuating its policy objectives.⁸⁹⁸ Further, the Commission believes that the exclusion should extend to foreign central banks, sovereign entities and international financial institutions for reasons of international comity.⁸⁹⁹ In light of ongoing expectations that Federal Reserve Banks and agencies of the Federal Government will not be subject to foreign regulatory requirements in their transactions in the sovereign debt of other nations, the Commission believes principles of international comity counsel in favor of exempting foreign central banks, sovereign authorities, and international institutions.

The Commission is also excluding transactions between U.S. Treasury CCA members and natural persons from the requirement to clear eligible secondary market transactions. The Commission believes that natural persons generally transact in small volumes and should not present much, if any, contagion risk to a U.S. Treasury securities CCA and therefore, the benefits discussed above are unlikely to be important for these transactions. Commenters expressed support for these exclusions.⁹⁰⁰

Two commenters asked the Commission to adopt an exemption that would allow FCMs to continue to engage in eligible secondary market transactions in U.S. Treasury securities outside of central clearing, and another commenter acknowledged the potential interaction between the

⁸⁹⁸ See Proposing Release, *supra* note 14, for a discussion of the activities of Federal Reserve Bank of New York's open market operations conducted at the direction of the Federal Open Market Committee.

⁸⁹⁹ See *id.*, for a discussion of the Commission's belief in the principles of international comity.

⁹⁰⁰ SIFMA/IIB Letter, *supra* note 37, at 20; CME Letter, *supra* note 81.

proposal and the regulatory framework governing FCMs.⁹⁰¹ FCMs can also be registered with the Commission as broker-dealers.⁹⁰² Commenters expressed concern as to whether the account structure provided by FICC would be consistent with the regulatory framework governing FCMs.⁹⁰³ The Commission recognizes the apparent tension between the rule amendments being adopted and the application of Rule 1.25(d)(2), as described in part II.A.2.a.iv, *supra*.

For the reasons discussed above in part II.A.2.a.iv, the Commission does not believe that an exclusion for FCMs is necessary to accommodate the relevant provisions of the CFTC Rules. Moreover, an exclusion for FCMs would be inconsistent with the purpose of the rule which is to help reduce contagion risk to the CCA and bring the benefits of central clearing to more transactions involving U.S. Treasury securities, particularly in light of their significance to the Treasury market.

b. Other Changes to Covered Clearing Agency Standards

The Commission believes that certain additional changes to its Covered Clearing Agency Standards that apply only to U.S. Treasury securities CCAs are warranted to facilitate additional clearing. Such changes should help ensure that the U.S. Treasury securities CCA can continue to manage the risks arising from more transactions from additional indirect participants and to facilitate the increased use of central clearing and the accompanying benefits. These changes, by making central clearing more efficient for market participants, also create incentives for greater use of central clearing.

⁹⁰¹ See *supra* note 200. See also part II.A.2.a.iv, *supra*, for discussion of FCMs and the regulatory framework governing them.

⁹⁰² One commenter states that the majority of FCMs are dually registered as FCMs and broker-dealers. See FIA Letter, *supra* note 200, at 2.

⁹⁰³ See part II.A.2.a.iv, *supra*.

**i. Policies and Procedures Regarding Direct Participants’
Transactions**

The Commission is adopting Rule 17ad-22(e)(18)(iv)(B) that requires a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures to identify and monitor its direct participants’ required submission of transactions for clearing, including, at a minimum, addressing a direct participant’s failure to submit transactions. The Commission believes that such a requirement should help ensure that a U.S. Treasury securities CCA adopts policies and procedures directed at understanding whether and how its participants comply with the policies that will be adopted as part of the requirement to clear eligible secondary market transactions requiring the submission of specified eligible secondary market transactions for clearing. Without such policies and procedures, it would be difficult for the CCA to assess if the direct participants are complying with the requirement to clear eligible secondary market transactions.

One commenter supported this aspect of the proposal.⁹⁰⁴ This commenter anticipated that implementation of this aspect of the proposal would be similar to implementation of other Covered Clearing Agency Standards provisions that use that phrase.⁹⁰⁵ The commenter stated that it expects a U.S. Treasury securities CCA would take steps to remediate non-compliance on the part of its direct participants in a manner consistent with the Covered Clearing Agency Standards and breaches of the CCA’s own rules.⁹⁰⁶

⁹⁰⁴ See FICC/DTCC Letter, *supra* note 33, at 21-22. See also part II.A.4 *supra* for additional discussion.

⁹⁰⁵ *Id.*

⁹⁰⁶ *Id.*

ii. Netting and Margin Practices for House and Customer Accounts

The Commission is amending Rule 17ad-22(e)(6)(i) to require a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin amounts from a direct participant for its proprietary U.S. Treasury securities positions, separately and independently from margin calculated and collected from that direct participant in connection with U.S. Treasury securities transactions by an indirect participant that relies on the services provided by the direct participant to access the covered clearing agency's payment, clearing, or settlement facilities. As described further below, such changes should allow a U.S. Treasury securities CCA to better understand the source of potential risk arising from the U.S. Treasury securities transactions it clears and potentially further incentivize central clearing.

In practice, at FICC, clearing a U.S. Treasury securities transaction between a direct participant and its customer, *i.e.*, a dealer to client trade, would not result in separate collection of margin for the customer transaction. Except for transactions submitted under the FICC sponsored member program,⁹⁰⁷ FICC margins the transactions in the direct participant's (*i.e.*, the dealer's) account on a net basis, allowing any of the trades for the participant's own accounts to net against trades by the participant's customers.⁹⁰⁸

Under the amendments to Rule 17ad-22(e)(6)(i), a U.S. Treasury securities CCA is required to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate margin amounts for all transactions that a direct participant submits to the CCP on behalf of others, separately from the margin that is calculated for

⁹⁰⁷ See DTCC October 2021 White Paper, *supra* note 681.

⁹⁰⁸ *Id.* at 5-6.

transactions that the direct participant submits on its own behalf. Such policies and procedures must also provide that margin collateralizing customer positions be collected separately from margin collateralizing a direct participant's proprietary positions. Finally, the CCP will also be required to have policies and procedures reasonably designed to, as applicable, ensure that any margin held for customers or other indirect participants of a member is held in an account separate from those of the direct participant.

Because the amendments to Rule 17ad-22(e)(6)(i) require separating positions in U.S. Treasury securities transactions of a direct participant in a U.S. Treasury securities CCA from those of customers or other indirect participants, the indirect participants' positions, including those submitted outside of the sponsored member program, will no longer be netted against the direct participant's positions. The indirect participants' positions will be subject to the covered clearing agency's risk management procedures, including collection of margin specific to those transactions. These changes should allow a U.S. Treasury securities CCA to better understand the source of potential risk arising from the U.S. Treasury securities transactions it clears. In addition, these changes should help avoid the risk of a disorderly default in the event of a direct participant default, in that FICC will be responsible for the central liquidation of the defaulting participant's trades without directly impacting the trades of the participant's customers or the margin posted for those trades.

Moreover, the amendments to Rule 17ad-22(e)(6)(i) should result in dealer-to-customer trades gaining more benefits from central clearing. Because margin for a direct participant's (*i.e.*, a dealer's) trades will be calculated, collected, and held separately and independently from those of

an indirect participant, such as a customer, the direct participant's trades with the indirect participant can be netted against the direct participant's position vis-à-vis other dealers.⁹⁰⁹

Holding margin amounts from a direct participant of a U.S Treasury securities CCA separately and independently from those of an indirect participant may reduce incentives for indirect participants to trade excessively in times of high volatility.⁹¹⁰ Such incentives exist because the customers of a broker-dealer do not always bear the full cost of settlement risk for their trades. Broker-dealers incur costs in managing settlement risk with CCPs. Broker-dealers can recover the average cost of risk management from their customers. However, if a particular trade has above-average settlement risk, such as when market prices are unusually volatile, it is difficult for broker-dealers to pass along these higher costs to their customers because fees typically depend on factors other than those such as market volatility that impact settlement risk. Holding margin of indirect participants separately from direct participants should reduce any such incentives to trade more than they otherwise would if they bore the full cost of settlement risk for their trades.

Commenters generally supported the proposed amendment to Rule 17ad-22(e)(6)(i).⁹¹¹ However, commenters also raised several additional issues with respect to the separation of house and customer margin that are addressed in part II.B.1 *supra*. As discussed below,⁹¹² an additional commenter stated that the proposed separation of house and customer margin would negatively impact small and mid-size broker-dealers who are disproportionately affected by FICC's Excess Capital Premium ("ECP") charge, which is a margin add-on that collects a premium when a

⁹⁰⁹ See Marta Chaffee and Sam Schulhofer-Wohl, *supra* note 678, at 3.

⁹¹⁰ See Sam Schulhofer-Wohl, *Externalities in Securities Clearing and Settlement: Should Securities CCPs Clear Trades for Everyone?* (Fed. Res. Bank Chi. Working Paper No. 2021-02, 2021).

⁹¹¹ See note 33 *supra*.

⁹¹² See part IV.C.3.b *infra*.

member's VaR charge exceeds the member's Net Capital, net assets or equity capital (as applicable to that member based on its type of regulation).⁹¹³ As discussed in part II.B1 *supra*, the commenter's concerns regarding the interplay between purported required gross margining and the ECP charge rests on the assumption that gross margin is required under the proposal, which, as discussed in the prior paragraph, is not the case. In addition, FICC recently has indicated that it intends to make available client clearing models that do not require gross margin, consistent with its current offerings.⁹¹⁴

A commenter requested that the SEC encourage FICC to establish a feature allowing (but not requiring) registered fund sponsored members to support their obligations by having margin posted with FICC ("FICC registered fund margin framework") rather than by paying fees to the sponsoring member.⁹¹⁵ While the commenter noted that the Sponsored Service under current FICC rules does not raise custody issues for registered funds under the 1940 Act because registered funds are not required to post margin to FICC, if a fund's margin were permitted to be posted with FICC, that could raise custody issues for funds unless such funds had relief from certain provisions of the 1940 Act.⁹¹⁶ The commenter stated that permitting registered funds' margin to be posted with FICC could reduce costs for registered funds and facilitate their use of cleared reverse repos and term repos.⁹¹⁷ The Commission understands that FICC's current rules for the Sponsored Service do not require sponsored and sponsoring member margin to be

⁹¹³ IDTA Letter, *supra* note 66, at 4; IDTA Letter 2, *supra* note 829, at 7; *see also* FICC Rule 4, section 14, *supra* note 19.

⁹¹⁴ *See* DTCC 2023 White Paper, *supra* note 107, at 6 (discussing that the proposal would allow the option to calculate and collect margin associated with customer activity on a gross or net basis depending on the client clearing model selected by the member and stating that FICC would offer options via different access models that would allow those parties to balance the benefits of netting and segregation in different ways).

⁹¹⁵ *See supra* note 125.

⁹¹⁶ *See* part II.A.2.a.ii *supra*.

⁹¹⁷ ICI Letter, *supra* note 85.

calculated or held separately implying that the sponsoring member is satisfying all FICC margin requirements. Thus, current practice bundles trade execution and clearing, including the posting of margin. As such, registered funds in effect pay the costs associated with the posting of margin either through fees or through inferior pricing. Enabling registered fund margin to be posted at FICC creates the potential for unbundling these activities, and for greater competition.

The Commission agrees that facilitating the ability for a registered fund's margin to be posted at FICC as an alternative to the sponsoring member satisfying all FICC margin requirements and passing the cost of doing so through to the registered fund may lower the cost of trading for the fund, and the Commission's five year position discussed in part II.A.2.a.ii *supra*, will help facilitate the posting of registered fund margin to satisfy a U.S. Treasury securities CCA's margin deposit requirements. The ability to separate the trade execution and clearing services of sponsoring a registered fund's transactions with the CCA from the posting margin may facilitate done-away trading and enhance the ability of smaller CCA netting members to become sponsoring members or expand the capacity of sponsoring members in the Sponsored Service.

iii. Facilitating Access to U.S. Treasury Securities CCAs

The various access models currently available to access central clearing in the U.S. Treasury securities market may not meet the needs of the many different types of market participants who transact in U.S. Treasury securities with the direct members of a U.S. Treasury Securities CCA. The additional provision to Rule 17ad-22(e)(18)(iv)(C) requires a U.S. Treasury securities CCA to establish, implement, maintain and enforce certain written policies and procedures regarding access to clearance and settlement services, which, while not prescribing specific methods of access, is intended to ensure that all U.S. Treasury security CCAs have

appropriate means to facilitate access to clearance and settlement services in a manner suited to the needs of market participants, including indirect participants.

Some market participants have commented on the current practice of tying clearing services to trading under the sponsored clearing model.⁹¹⁸ Under this model, the decision to clear the trades of an indirect participant appears to be contingent on that indirect participant trading with the direct participant sponsoring the indirect member.⁹¹⁹ If the indirect participant is a competitor of the sponsoring direct participant and the direct participant has discretion on which trades to clear, the indirect participant may have difficulty accessing clearing. The rule requires the U.S. Treasury securities CCA to ensure appropriate means to facilitate access; for some current indirect participants this may imply direct membership (with a potential change in membership criteria); alternatively, requiring something similar to a “done-away” clearing model may be another means of facilitating clearing.

Other considerations relate to the services available through the sponsored clearing model. For example, buy-side participants, currently engage in both triparty and bilateral repo, across multiple tenors (both overnight and long term), and on either side (selling or buying) of the transaction. At present, it appears that FICC direct members may be able to decline to submit a trade with counterparties who are not FICC direct members for central clearing at their discretion.⁹²⁰ Thus some indirect participants who are unable to enter into a similar transaction using a different FICC direct member who is willing to submit the trade for central clearing would

⁹¹⁸ See Futures Industry Association Principal Traders Group, *Clearing a Path to a More Resilient Treasury Market*, at 10 (July 2021), available at https://www.fia.org/sites/default/files/2021-07/FIA-PTG_Paper_Resilient%20Treasury%20Market_FINAL.pdf (“FIA-PTG Whitepaper”).

⁹¹⁹ See *id.* at 7.

⁹²⁰ See part IV.B.3 *supra*.

not be able to access central clearing under the current practice. The rule requires FICC to create new policies and procedures to facilitate access to clearing for these participants.

One commenter opposed the inclusion of registered funds because the current clearing framework is not sufficiently developed to support such a central clearing requirement.⁹²¹ The commenter identified several issues to be addressed prior to adopting such a requirement, including improvements to the Sponsored Service and develop a “done away” model (*see* part II.B.2 *supra* for additional discussion of the issues raised by this commenter).

In addition, the Rule 17ad-22(e)(18)(iv)(C) requires the CCA’s written policies and procedures be annually reviewed by the CCA’s board of directors to ensure that the CCA 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. This review should help ensure that such policies regarding access to clearance and settlement services, including for indirect participants, are reviewed annually by the U.S. Treasury securities CCA’s board of directors. The annual review ensures that such policies and procedures be reviewed periodically and potentially updated to address any changes in market conditions.

c. Amendments to Rules 15c3-3 and 15c3-3a

The rules and rule amendments being adopted and that are discussed above could cause a substantial increase in the margin broker-dealers must post to a U.S. Treasury securities CCA resulting from their customers’ cleared U.S. Treasury securities positions. 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 U.S. Treasury securities CCA. This is because no U.S. Treasury securities CCA has implemented rules and practices designed to

⁹²¹ ICI Letter, *supra* note 85.

segregate customer margin and limit it to being used solely to cover obligations of the broker-dealer's customers. Therefore, increases in the amount of margin required to be deposited at a U.S. Treasury securities CCA as a result of the requirement to clear eligible secondary market transactions 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 permits, under certain conditions, margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula. This new debit item will 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 U.S. Treasury securities CCA. The amendment allows a customer's broker to use customer funds to meet margin requirements at the CCP generated by the customer's trades, lowering the cost of providing clearing services.

As discussed further below, we expect these changes to allow more efficient use of margin for cleared trades relative to the baseline. This change, alone, could create incentives for greater use of central clearing, and thus could promote the benefits described in previous sections.

Overall, commenters supported the proposal to permit this debit item.⁹²² One commenter stated that the practical effect of this change would be to allow broker-dealers to use margin collected from customers to satisfy margin requirements associated with such customers' transactions, rather than using proprietary funds to finance customer margin as is the case today, and expressed its support for this amendment because it will free up broker-dealer resources by reducing the amount of proprietary funds needed to finance customer margin and therefore lower

⁹²² See *supra* note 446.

the cost of clearing, while continuing to protect customer funds.⁹²³ Another commenter stated that this change would reduce the costs of centrally clearing U.S. Treasury securities transactions and thus incentivize more central clearing of such transactions.⁹²⁴

2. Costs

The Commission has, where practicable, attempted to quantify the economic effects it expects may result from the amendments and new rules that it is adopting. In some cases, however, data needed to quantify these economic effects is not currently available or depends on the particular changes made to the U.S. Treasury securities CCA policies and procedures. As noted below, in the Proposing Release the Commission was unable to quantify certain economic effects and solicited comment, including estimates and data from interested parties, which could help inform the estimates of the economic effects of the new rules and amendments.

Significant costs of central clearing for market participants may include: (i) initial margin requirements (which in practice are held as “clearing fund” at FICC and subject to loss mutualization and the attendant adverse capital implications); (ii) clearing fees; (iii) obligations with respect to FICC’s capped contingency liquidity facility (“CCLF”); (iv) the operational build necessary to access central clearing (either as a direct participant or as an indirect participant); and (v) legal costs and time associated with onboarding customers for indirect central clearing, including, *e.g.*, the need for Sponsoring Members to file UCC financing statements with respect to Sponsored Members under the Sponsored Member program. These costs are discussed in more detail below. Not all costs are expected to be borne by all participants and may depend on rules of the clearing agency.

⁹²³ See MFA Letter, *supra* note 81, at 10.

⁹²⁴ See SIFMA/IIB Letter, *supra* note 37, at 12.

One commenter stated that the increased costs of centrally clearing U.S. Treasury security transactions may reduce liquidity and diversity in the Treasury market if firms reduce activity, leave the market, or if barriers to entry are too high, given the significant costs of clearing for market participants.⁹²⁵ The commenter identified several types of costs, including initial margin requirements, clearing fees, obligations with respect to FICC's CCLF, the operational build necessary to access central clearing either as a direct or indirect participant, and legal costs and time associated with onboarding customers for indirect central clearing, including, *e.g.*, the need for Sponsoring Members to file UCC financing statements with respect to Sponsored Members under the Sponsored Member program. The commenter stated that the impact of these costs would be disproportionately felt by small and mid-sized participants in the U.S. Treasury market, and that they would reduce diversity in the market and further increase concentration among market participants (which may increase systemic risk) if such participants leave the market.⁹²⁶

Increased transaction costs will, all else equal, reduce the expected return of a particular investment. If this were the only effect then the risk/return tradeoff would worsen and transaction volume could fall and liquidity deteriorate. However, central clearing also provides numerous benefits described above, including a possible decrease in transaction costs.⁹²⁷ Many of these benefits could be expected to particularly benefit small and mid-sized participants, for example the reduction in counterparty credit risk that can result from central clearing may particularly benefit smaller market participants.

Commenters mentioned the potential concentration risk that would arise because of the requirement to clear eligible secondary market transactions, specifically because only one covered

⁹²⁵ See SIFMA/IIB Letter, *supra* note 37.

⁹²⁶ See SIFMA/IIB Letter, *supra* note 37, at 8.

⁹²⁷ See part IV.C.1 *supra*.

clearing agency currently provides such services. One commenter stated that concentrating such significant levels of settlement, operational, liquidity and credit risk in one institution means that were there operational or liquidity stress at FICC, widespread dysfunction in the Treasury markets could result.⁹²⁸ One commenter agreed that the existence of one covered clearing agency serving the U.S. Treasury market is highly problematic as it creates enormous concentration risk for market participants, and highlighted that, given the importance of the U.S. Treasury market to the overall global economy, there needs to be a compelling reason for increasing the concentration of cleared trading activity in a single clearing house particularly when there is no alternative or fallback venue should the clearing house experience a disruption to its operations or more significantly were to fail.⁹²⁹

The Commission also recognizes the risks associated with increased centralization of clearance and settlement activities. In particular, the Commission has previously noted that “[w]hile providing benefits to market participants, the concentration of these activities at a covered clearing agency implicitly exposes market participants to the risks faced by covered clearing agencies themselves, making risk management at covered clearing agencies a key element of systemic risk mitigation.”⁹³⁰

As discussed previously, currently only FICC provides CCP services for U.S. Treasury securities transactions, including outright cash transactions and repos.⁹³¹ Were FICC unable to provide its CCP services for any reason then this could have a broad and severe impact on the overall U.S. economy. The FSOC recognized this when it designated FICC as a systemically

⁹²⁸ See SIFMA/IIB Letter, *supra* note 37, at 10.

⁹²⁹ SIFMA/AMG Letter, *supra* note 37, at 9.

⁹³⁰ See CCA Standards Proposing Release, *supra* note 8, 79 FR at 29587.

⁹³¹ See Proposing Release, *supra* note 14 at 64612. See also part II.A.1.b *supra*.

important financial market utility in 2012,⁹³² which subjects it to heightened risk management requirements and additional regulatory supervision, by both its primary regulator and the Board of Governors.⁹³³ In addition, FICC is subject to the Covered Clearing Agency Standards, which address the various types of risk that FICC faces as a CCP, including settlement, operational, liquidity, and credit risk. FICC also must meet its obligations under both Section 19(b) of the Exchange Act, as a self-regulatory organization, and Title VIII of the Dodd-Frank Act. The Commission believes that this overall supervisory framework, including the Covered Clearing Agency Standards, should help ensure that FICC continues to be subject to robust supervision and oversight and to be able to manage the risks presented to it, even those arising from increased Treasury clearing.

**a. Costs to FICC and its Members of the Requirement to Clear
Eligible Secondary Market Transactions**

The Commission believes that many of the direct costs of the rules and amendments it is adopting to the U.S. Treasury securities CCA are a result of new policies and procedures requirements, the costs of which are likely to be modest. This is because all but one of these amendments and rules require the CCA to make certain changes to its policies and procedures. The other amends Rule 15c3-3a to permit margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula for broker-dealers,

⁹³² See *supra* note 369.

⁹³³ *Id.* at 119. As the Commission has previously stated, “Congress recognized in the Clearing Supervision Act that the operation of multilateral payment, clearing or settlement activities may reduce risks for clearing participants and the broader financial system, while at the same time creating new risks that require multilateral payment, clearing or settlement activities to be well-designed and operated in a safe and sound manner. The Clearing Supervision Act is designed, in part, to provide a regulatory framework to help deal with such risk management issues, which is generally consistent with the Exchange Act requirement that clearing agencies be organized in a manner so as to facilitate prompt and accurate clearance and settlement, safeguard securities and funds and protect investors. See CCA Standards Proposing Release, *supra* note 8, 76 FR at 14474; see also 12 U.S.C. 5462(9), 5463(a)(2).

subject to the conditions discussed above. As discussed above, the amendments to Rule 15c3-3a require several conditions to be met, including that the U.S. Treasury securities CCA calculate a separate margin amount for each customer on a gross basis.⁹³⁴ Comments submitted by the single current U.S. Treasury securities CCA acknowledged that it would need to make documentation, operational, organizational, and systems changes in order to comply with the proposal.⁹³⁵

Rule 17ad-22(e)(18)(iv) requires a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures, as discussed above.⁹³⁶ Because policies and procedures regarding the clearing of all eligible secondary market transactions entered into by a direct participant in a U.S. Treasury securities CCA are not currently required under existing Rule 17ad-22, the Commission believes that Rule 17ad-22(e)(18)(iv) may require a covered clearing agency to make substantial changes to its policies and procedures. The rule amendment contains similar provisions to existing FICC rules but will also impose additional requirements that do not appear in existing Rule 17ad-22. As a result, the Commission believes that a U.S. Treasury securities CCA will incur burdens of reviewing and updating existing policies and procedures in order to comply with the provisions of Rule 17ad-22(e)(18)(iv) and, in some cases, may need to create new policies and procedures.⁹³⁷

⁹³⁴ See part II.C.2.c *supra*.

⁹³⁵ See DTCC/FICC Letter, *supra* note 33, at v. Although DTCC/FICC acknowledged there would be required system and other changes, it did not provide any estimate of the costs of such changes.

⁹³⁶ See part II.A.4 *supra* for a discussion of the requirement that a U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, identify and monitor its direct participants' required submission of transactions for clearing, including, at a minimum, addressing a direct participant's failure to submit transactions. See part II.B.2 *supra* for a discussion of the requirement that U.S. Treasury securities CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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, which policies and procedures the U.S. Treasury securities CCA's board of directors reviews annually.

⁹³⁷ See part IV.C.2.c.ii, *infra*.

The Commission estimates that U.S. Treasury securities CCAs will incur an aggregate one-time direct cost of approximately \$207,000 to create new policies and procedures.^{938, 939} The rule also requires ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. The Commission estimates that the ongoing activities required by Rule 17ad-22(e)(18)(iv) impose an aggregate ongoing cost on covered clearing agencies of approximately \$61,000 per year.⁹⁴⁰

i. Costs attendant to an increase in CCLF

The new rules and amendments being adopted will likely result in a significant increase in the volume of U.S. Treasury securities transactions submitted to clearing. The G-30 has reported that FICC differs qualitatively from other CCPs in that counterparty credit risks are relatively small but liquidity risks in the event of member defaults could be extraordinarily large.⁹⁴¹ This is because net long positions generate liquidity obligations for FICC since, in the event of a member default, FICC would have to deliver cash in order to complete settlement of such positions with non-defaulting parties. Increased clearing volume of cash and repo transactions as a result of the rule could increase FICC's credit and liquidity exposure to its largest participant family, including

⁹³⁸ To monetize the internal costs, the Commission staff used data from SIFMA publications, modified by Commission staff to account for an 1800 hour work-year and multiplied by 5.35 (professionals) or 2.93 (office) to account for bonuses, firm size, employee benefits and overhead. *See* SIFMA, Management and Professional Earnings in the Security Industry – 2013 (Oct. 7, 2013); SIFMA, Office Salaries in the Securities Industry – 2013 (Oct. 7, 2013). These figures have been adjusted for inflation using data published by the Bureau of Labor Statistics.

⁹³⁹ This figure was calculated as follows: Assistant General Counsel for 40 hours (at \$518 per hour) + Compliance Attorney for 80 hours (at \$406 per hour) + Computer Operations Manager for 20 hours (at \$490 per hour) + Senior Risk Management Specialist for 40 hours (at \$397 per hour) + Business Risk Analyst for 80 hours (at \$305 per hour) = \$103,280 x 2 respondent clearing agencies = \$206,560. *See* part V.A *infra*.

⁹⁴⁰ This figure was calculated as follows: Compliance Attorney for 25 hours (at \$406 per hour) + Business Risk Analyst for 40 hours (at \$305 per hour) + Senior Risk Management Specialist for 20 hours (at \$397 per hour) = \$30,290 x 2 respondent clearing agencies = \$60,580. *See* part V.A *infra*.

⁹⁴¹ G-30 Report, *supra* note 5, at 14.

those participants acting as sponsors of non-members.⁹⁴² FICC is obligated by Commission rule to maintain liquidity resources to settle all obligations of its largest participant family, in the event of default.⁹⁴³ These resources include the CCLF in which Members will be required to hold and fund their deliveries to an insolvent clearing member up to a predetermined cap by entering into repo transactions with FICC until it completes the associated close-out. This facility allows clearing members to effectively manage their potential financing requirements with predetermined caps.⁹⁴⁴

As reported in the CPMI-IOSCO disclosure by FICC for Q2 of 2023, the combined liquidity commitment by clearing members to the FICC's CCLF was \$86.3 billion for all repos and cash trades of U.S. Treasury and Agency securities. Since the inception of the CCLF in 2018, the CCLF has ranged in size from \$82.5B to \$108B.⁹⁴⁵ Commitments by bank-affiliated dealers to the CCLF count against regulatory liquidity requirements, including the Liquidity Coverage Ratio (LCR).⁹⁴⁶ Dealers affiliated with banks may satisfy their CCLF obligations using a guarantee from that affiliated bank but dealers not affiliated with banks may incur costs to obtain commitments to meet CCLF liquidity requirements. FICC states that when examining the impact of the rule amendments being adopted, its findings are inconclusive about the potential impact of the incremental indirect participant Treasury volume on FICC's liquidity needs or its CCLF.⁹⁴⁷

⁹⁴² Participant family means that if a participant directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another participant then the affiliated participants shall be collectively deemed to be a single participant family. *See* Rule 17ad-22(a).

⁹⁴³ *See* part IV.B.3 *supra*.

⁹⁴⁴ FICC Disclosure Framework 2021 at 88, available at https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf.

⁹⁴⁵ *See* part IV.B.3 *supra*.

⁹⁴⁶ LCR is calculated as the ratio of High-Quality Liquid Assets (HQLA) divided by estimated total net cash outflow during a 30-day stress period. Because commitments by bank-affiliated dealers to the CCLF would increase the denominator of the ratio, a bank-affiliated dealer would have to increase HQLA to reach a required level of LCR.

⁹⁴⁷ *See* DTCC 2023 White Paper, *supra* note 107, at 3, 19.

The size and cost of a firm’s liquidity plan is tied not only to its own exposure at FICC, but also to the maximum exposure of the largest systemically important financial institution (“SIFI”) banks. One commenter stated that its members have reduced their portfolios as part of their CCLF liquidity plans.⁹⁴⁸ At the same time, SIFIs have increased the size of their portfolios, and correspondingly, the very risk that the CCLF was designed to reduce.⁹⁴⁹

**ii. Costs of the Requirement to Clear Eligible Secondary Market
Transactions in terms of increased margining for existing FICC
members**

As discussed above, the Commission recognizes that these amendments could cause an increase in the margin clearing members must post to a U.S. Treasury securities CCA resulting from the additional transactions that will be submitted for clearing as a result of these amendments. Although various SRO margin rules provide for the collection of margin for certain transactions in U.S. Treasury securities, the Commission understands that transactions between dealers and institutional customers are subject to a variable “good-faith” margin standard, which the Commission understands – based on its supervisory experience – can often result in fewer financial resources collected for margin exposures than those that would be collected if a CCP margin model, like the one used at FICC, were used.⁹⁵⁰ Mitigating the potential for higher margin requirements for transactions submitted for clearing at a U.S. Treasury securities CCA is the benefit of netting that results from additional centrally cleared transactions.⁹⁵¹ As described in part IV.C.1 *supra*, this mitigant is likely to be especially significant in the case of IDB members. Also,

⁹⁴⁸ IDTA Letter, *supra* note 66, at 8-9.

⁹⁴⁹ *Id.*

⁹⁵⁰ See *supra* note 27.

⁹⁵¹ See part IV.C.1 *supra* for a discussion of the benefits of multilateral netting expected to result from higher volumes of centrally cleared transactions.

potentially substantially mitigating the costs for clearing members is the ability for broker-dealers to include a debit in the customer reserve formula equal to the amount of margin required and on deposit at a U.S. Treasury securities CCA, as described in part II.C *supra*.

Based on a survey of its members, FICC estimates that incremental indirect participant Treasury volume could result in a corresponding increase in Value at Risk (VaR) margin of approximately \$26.6 billion across the FICC/GSD membership.^{952,953} Netting members' required fund deposits to the clearing fund are primarily driven by a VaR charge; however, other margin charges may be collected when applicable.⁹⁵⁴ The cost to the netting members of the additional required fund deposits estimated by FICC is likely be less than this for three reasons. First, the definition of an eligible secondary market transaction with respect to cash transactions that is being adopted is narrower than that which was proposed and on which FICC's estimates were based. Second, some fraction of the additional secondary market transactions that will be centrally cleared

⁹⁵² See DTCC 2023 White Paper, *supra* note 107, at 3, 16. FICC estimates that, in aggregate, there will be an incremental \$500 billion of indirect participant Treasury repo activity, \$520 billion of indirect participant Treasury reverse repo activity and \$605 billion of indirect participant Treasury cash activity that could be submitted to FICC under the Proposing Release if it were adopted. The increase in margin is based on this estimate of increased central clearing activity. The estimates assume that all incremental indirect participant volume clears through one of FICC's client clearing models that calculate margin on a gross basis. The estimates could decrease if the activity were cleared through one of FICC's client clearing models that calculate margin on a net basis. See also note 377, *supra*, regarding margin methodologies. BNY Mellon estimates as much as \$370 billion in additional Treasury cash activity and \$2.8 trillion in additional Treasury repo and reverse repo activity that could be submitted to FICC although they note that exemptions could reduce these amounts. See BNY Mellon, *Reassembly Required: Central Clearing could Reshape the U.S. Treasury Market* (November 2023), available at <https://www.bnymellon.com/us/en/insights/all-insights/central-clearing-us-treasury-market.html>.

⁹⁵³ There is uncertainty among market participants about how much additional margin would have to be collected by FICC. For example, in an article in the Financial Times' Alphaville, an analyst at Barclays is quoted as estimating the additional margin could be \$45 billion. Bryce Elder, *Repo reform is a \$2tn mystery wrapped in an enigma of dodgy data*, FT Alphaville (Oct.13, 2023), available at <https://www.ft.com/content/518cbd3b-b1ed-4c3e-bd5e-9ac5bee99d9f>. The discussion concluding that the cost to netting members of the additional required fund deposits estimated by FICC applies to this alternative estimate as well.

⁹⁵⁴ See DTCC, *F.A.Q. FICC – Risk Management*, available at <https://www.dtcc.com/USTclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Risk-Management-FAQ.pdf> (last visited Dec. 11, 2023).

due to the new rules that would otherwise have been cleared bilaterally would also have been subject to margin requirements. Finally, since margin is only posted pending settlement, the cost to the posting entity is the opportunity cost of the funds.

One commenter, on behalf of its broker-dealer members, stated that there is a transaction cost difference between current bilateral trades that are cleared using the triparty platform and an identical transaction that must be centrally cleared.⁹⁵⁵ The commenter further noted that this cost across a volume of trades is borne by clients of broker-dealers. The commenter stated that while the actual costs may vary across its membership, its members are currently paying about \$3.00 per transaction settled on the triparty platform and bilaterally cleared over \$7.00 for a similar tri-party transaction that was centrally cleared through FICC. The commenter stated that this is because FICC imposes intraday and end-of-day position management charges, among other charges, making it materially cost prohibitive to transact with FICC and thereby increasing the cost of trading to the end customer. Besides the direct impact of these costs, which could limit trading, costs of central clearing may incentivize non-direct participants of a Treasury CCP to look for ways to trade away from direct participants in order to not have to centrally clear Treasury transactions, negatively affecting both liquidity and competition.

Several commenters discussed facilitating cross-margining of indirect participants' transactions in U.S. Treasury securities with those in U.S. Treasury futures as a method to lower costs of trading and thereby incentivize additional clearing.⁹⁵⁶ One commenter stated that cross-margining would lower costs for market participants by allowing them to apply margin across positions submitted for clearing through various clearinghouses. The commenter stated that this

⁹⁵⁵ IDTA Letter, *supra* note 66, at 4.

⁹⁵⁶ MFA Letter at 11; SIFMA/IIB Letter, *supra* note 37, at 13; SIFMA AMG Letter at 8.

would ensure that a market participant can post margin adequate to support its positions without having to post margin in excess of regulatory requirements due to an inability to apply margin across platforms.⁹⁵⁷ As discussed above, other commenters made additional suggestions lowering costs by creating additional cross margining opportunities.⁹⁵⁸ The current cross-margining agreement between FICC and CME is part of the GSD rulebook, and any changes to it have to be filed with the Commission pursuant to Section 19(b) of the Exchange Act. The Commission agrees that cross-margining can be beneficial to market participants.⁹⁵⁹ Rules requiring segregation of client margin should facilitate cross-margining. If such cross-margining were adopted, some costs of clearing would be mitigated.

One commenter stated that central clearing can have procyclical effects in times of market stress due to the margin requirements of clearing agencies, further reducing liquidity when it is most needed.⁹⁶⁰ The commenter stated that, depending on the applicable margin models, clearing can be procyclical in times of market turmoil, as increased margin requirements (including intraday and ad hoc calls) drive demand for liquid assets, which, in turn, increases the scarcity of those assets and further drives market stress. The commenter described FICC's rules as allowing FICC to demand, at any time in its discretion, additional margin from its members in times of market volatility, including through intraday calls, to safeguard the clearing infrastructure.⁹⁶¹

The Commission acknowledges that, in times of market stress, margin calls may increase to address the ongoing market volatility. This is by design, as margin models are built to be

⁹⁵⁷ MFA Letter at 11.

⁹⁵⁸ See part II.A.1.a *supra*.

⁹⁵⁹ *Id.*

⁹⁶⁰ SIFMA/IIB Letter, *supra* note 37, at 9.

⁹⁶¹ *Id.*

responsive to current market conditions. The Commission has specifically required that CCAs have the authority and operational capacity to make intraday margin calls in defined circumstances.⁹⁶² This ability is important to the CCA's ability to manage the risk and cover the credit exposures that its participants may bring to the CCA. When considering a CCA's authority with respect to intraday margin, the Commission may consider its potential procyclicality.⁹⁶³ In addition, the Commission may consider the transparency of the margin model, such that market participants can understand when the CCA may make margin calls.⁹⁶⁴ In addition to the FICC rules cited by the commenter, FICC has provided additional transparency regarding how it determines the need for intraday margin calls, including the specific criteria that it uses to assess the need.⁹⁶⁵ FICC is also subject to Rule 17ad-22(e)(23), which requires certain levels of public

⁹⁶² 17 CFR 240.17ad-22(e)(6)(ii).

⁹⁶³ *See, e.g.*, Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change to Modify the Calculation of the MBSD VaR Floor to Incorporate a Minimum Margin Amount, Exchange Act Release No. 92303, at 32 (June 30, 2021) (discussing commenter's concern regarding potential procyclical nature of a margin methodology change); Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change Concerning The Options Clearing Corporation's Margin Methodology for Incorporating Variations in Implied Volatility, Exchange Act Release No. 95319, at 3 (July 19, 2022) (referencing the impact of a change to margin methodology on procyclicality of margin).

⁹⁶⁴ *See, e.g.*, Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving a Proposed Rule Change to Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs and Make Certain Other Changes to Procedure XV, Exchange Act Release No. 34-90502, at 56-59 (Nov. 24, 2020) (discussing commenter's concerns regarding transparency of change to margin methodology).

⁹⁶⁵ *See* Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Changes to the Required Fund Deposit Calculation in the Government Securities Division Rulebook, Exchange Act Release No. 82588 (Jan. 26, 2018) (identifying the following specific parameter breaks: (i) a dollar threshold that evaluates whether a Netting Member's Intraday VaR Charge equals or exceeds a set dollar amount (then set at \$1,000,000) when compared to the VaR Charge that was included in the most recently collected Required Fund Deposit including, any subsequently collected Intraday Supplemental Fund Deposit; (ii) a percentage threshold, that evaluates whether the Intraday VaR Charge equals or exceeds a percentage increase (then set at 100%) of the VaR Charge that was included in the most recently collected Required Fund Deposit including, if applicable, any subsequently collected Intraday Supplemental Fund Deposit; (iii) the coverage target, that evaluates whether a Netting Member is experiencing backtesting results below the 99% confidence level). FICC has updated this information via Important Notices to its participants. *See, e.g.*, Important Notice GOV1244-22, GSD Intraday Supplemental Fund Deposit Parameter Change (Apr. 11, 2022), available at <https://www.dtcc.com/-/media/Files/pdf/2022/4/11/GOV1244-22.pdf> (raising the coverage target).

disclosure regarding FICC’s margin methodology and the costs of participating in FICC, as discussed further in part II.B.2 *supra*. The Commission’s ongoing consideration of the role and function of intraday margin calls, as well as market participants’ ability to understand such calls, obviates the need for separate study in connection with this proposal.⁹⁶⁶

iii. Other Costs

Several commenters raised additional issues related to costs or limitations on benefits of the new rules and amendments. One commenter explained that registered funds’ access to the Treasury repo market could be restricted by the number or willingness of the FICC netting members to provide sponsoring services, with attending negative effect on the market liquidity.⁹⁶⁷

Commenters have raised concerns that increases in demand for the Sponsored Service may put pressure on existing sponsoring members and reduce their ability or willingness to onboard additional clients. Such outcomes may result in these market participants not being able to trade with some of the largest banks and broker dealers who are direct members of FICC unless they are able to access clearing using an alternative clearing model, reducing the number of potential counterparties, possibly raising trading costs. Demand for sponsored access to clearing could also drive up the price of providing such services and provide an incentive for new competitors to enter the market for providing sponsored clearing services. Alternatively, it is possible that as part of review of its access models and related policies and procedures required by Rule 17ad-22(e)(18)(iv)(C), that FICC may modify its access models in a way that results in improved access for market participants who otherwise be so affected. Another commenter explained the impact of

⁹⁶⁶ See also Proposed Rule, Covered Clearing Agency Resilience and Recovery and Wind-Down Plans, Exchange Act Release No. 97516 (May 17, 2023), 88 FR 34708 (May 30, 2023) (proposing additional requirements with respect to intraday margin that CCAs require intraday monitoring of their exposures and specifying particular circumstances in which the CCA should make intraday margin calls).

⁹⁶⁷ ICI Letter, *supra* note 85, at 30-31.

the ECP charge in conjunction with FICC’s Sponsored Service, stating that “the combination of gross margining and ECP currently in use under the Sponsored Model, and what is prescribed in the Proposed Rule, effectively prevents smaller and middle market broker dealers from materially participating in the Treasury market.”⁹⁶⁸

However, another commenter explained that, in addition to the Sponsored Service, the U.S. Treasury securities CCA offers a variety of way to access central clearing for indirect participants.⁹⁶⁹ For example, FICC’s Prime Brokerage Clearing and Correspondent Clearing models currently support clearing of transactions between indirect participants although, at present, these models are rarely used.⁹⁷⁰ As stated in the Proposing Release, the Commission continues to believe that the U.S. Treasury securities CCA generally should consider a wide variety of 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. In view of the critical services it provides, the U.S. Treasury securities CCA generally should seek to provide access in as flexible a means as possible, consistent with its responsibility to provide sound risk management and comply with other provisions of the Exchange Act, the Covered Clearing Agency Standards, and other applicable regulatory requirements.

⁹⁶⁸ IDTA Letter, *supra* note 66, at 5. This commenter’s stated concern regards the interplay between the ECP and gross margining and rests on the assumption that gross margining is required by the rule which is not the case. *See supra* part II.B.1. However, the ECP in its current form may impact the willingness of small and middle market broker dealers from sponsoring additional market participants.

⁹⁶⁹ DTCC Letter, *supra* note 33, at 18-21.

⁹⁷⁰ *Id.* at 20.

**b. Costs to non-members of a U.S Treasury securities CCA as a result
of the Requirement to Clear Eligible Secondary Market
Transactions**

The requirement to clear eligible secondary market transactions requires that all repo transactions with a direct participant be centrally cleared and that certain cash transactions with a direct participant to be centrally cleared. The costs incurred by non-members of a U.S. Treasury securities CCA to comply with this requirement will depend on the policies and procedures developed by the CCA, as discussed in parts IV.C.2.a *supra* and IV.C.2.d *infra*.

As stated above, the Commission believes that these amendments will increase central clearing in the U.S Treasury securities market. Transactions that are not currently submitted for central clearing but would be under the amendments being adopted will be subject to certain transaction, position, and other fees as determined by the U.S. Treasury securities CCA.⁹⁷¹

Market participants who enter into eligible secondary market transactions with members of U.S. Treasury securities CCAs who do not have access to clearing may incur costs related to establishing the required relationships with a clearing member in order to submit the eligible transactions for clearing. These market participants may also incur additional costs related to the submission and management of margin. It is possible that such market participants may seek alternative counterparties that are not U.S. Treasury securities CCA members in order to avoid incurring these costs.

As discussed in the baseline, the majority of repo and cash transactions in the dealer-to-customer segment are not centrally cleared. This differentiates the U.S. Treasury securities market from the markets for swaps and for futures. There is currently some clearing of customer repo; the

⁹⁷¹ The fee structure for FICC is described in its rulebook. *See* FICC Rules, *supra* note 19, at 307.

majority of this clearing is “done-with” – the clearing broker and the counterparty are one and the same. However, in the swaps and futures markets, and in the equities market, clearing is “done-away” – meaning that the clearing broker may be other than the trading counterparty. Market participants have identified costs with the done-with model. Market participants in the secondary market for U.S Treasury securities that will be required to be centrally cleared could incur direct costs for arranging clearing-related legal agreements with every potential counterparty. Depending on the customer there may be a large number of such arrangements.

There are indirect costs arising when a trading counterparty is a competitor. For example, the pricing and offering of clearing services may be determined by forces other than the costs and benefits of the clearing relationship itself, such as the degree of competition between the counterparties. Other economic arrangements facilitating customer clearing are possible and may develop, as in other markets.⁹⁷² One such arrangement is direct CCA membership. However, for smaller entities, CCA membership may not be economically viable, and for some entities, legal requirements may prevent direct membership. Another possibility is seeking out counterparties other than CCA members. The “done away” structure of clearing has worked effectively in other markets, and, if it were to develop so that all market participants with demand could trade using the “done-away” structure, would significantly mitigate these costs.

Some participants may not currently post margin for cash clearing and may be now required to do so, depending on the form the clearing relationship takes. There may be costs associated with the transfer of margin. An institutional investor self-managing its account would instruct its custodian to post margin with the CCA on the execution date, and post a transaction in its internal accounting system showing the movement of margin. The day after trade execution,

⁹⁷² See FIA-PTG Whitepaper, *supra* note 918 (for a description of different client clearing models).

the investor would oversee the return of margin from FICC, with an attendant mark of a transaction on the investor's internal accounting system. Similar steps would occur for an institutional investor trading through an investment adviser, though in this case the adviser might instruct the custodian and mark the transaction, depending on whether the adviser has custody. The institutional investor might also pay a wire fee associated with the transfer of margin.

Besides the costs of developing new contracts with counterparties to support central clearing, there will also be a cost to non-CCA members associated with margin, to the extent that more margin is required than in a bilateral agreement. This cost of margining is analogous to that borne by CCA members and is discussed further above.

As a result of the rule, a potential cost to money market fund participants that face FICC as a counterparty is that the funds' credit ratings could be affected if FICC becomes a substantially large counterparty of these participants, which could be interpreted by credit models and ratings methodologies as a heightened concentration risk factor. As concentration risk in a CCP is typically not viewed in the same way as concentration risk with a bilateral trading party, credit rating agencies may quickly adapt their methods to distinguish the CCA from a conventional counterparty. In the absence of such changes at credit rating agencies, money market fund participants may find it necessary to either alter their investment strategies to substitute purchases of Treasury securities for repo or to enter into repo transactions with entities that are not direct members of a Treasury securities CCA.

As discussed above, increased demand for the Sponsored Service and the existence of compliance and capital costs for sponsoring members may limit the ability of some market participants to access clearing through the Sponsored Service. Unless these market participants are able to access clearing through alternative clearing models, they may be unable to trade repo with

some of the largest banks and broker dealers who are direct members of FICC, reducing the number of potential counterparties, and possibly resulting in inferior pricing for such market participants. Alternatively, it is possible that as part of review of its access models and related policies and procedures required by Rule 17ad-22(e)(18)(iv)(C), that FICC may modify its access models in a way that results in improved access for market participants who otherwise be so affected.

One commenter argued that including triparty repos in the definition of an eligible secondary market transaction would likely impair the cash and collateral management processes of hedge funds and alternative asset managers.⁹⁷³ Specifically, the commenter suggested that such firms currently conduct same-day bilateral transactions that they would not be able to conduct with a direct participant of a U.S. Treasury securities CCA required to centrally clear its repo transactions.⁹⁷⁴

The Commission disagrees with this commenter. In its supervisory capacity, the Commission is aware that registered funds, hedge funds, and alternative asset managers currently conduct centrally cleared triparty repo transactions. For example, the Commission is aware that numerous hedge funds conduct such same-day transactions as sponsored members of FICC. Therefore, the existing operational infrastructure supports centrally cleared triparty repo transactions.

As discussed above, two commenters asked the Commission to adopt an exemption that would allow FCMs to continue to engage in eligible secondary market transactions in U.S. Treasury securities outside of central clearing.⁹⁷⁵ For the reasons discussed above in part

⁹⁷³ See MFA Letter at 17.

⁹⁷⁴ See *id.*

⁹⁷⁵ See *supra* note 901 and referencing text.

II.A.2.a.iv *supra*, the Commission is not excluding repo transactions between FICC netting members and FCMs from the definition of eligible secondary market transactions. However, the Commission recognizes that the tension between the rules governing FCMs and the rule amendments being adopted may raise costs for FCMs if it restricts the choice of models that can be used to access central clearing or reduces the number of potential counterparties. For example, one of the commenters explained that FCMs are permitted to invest customer funds in certain securities determined by the CFTC to be “consistent with the objectives of preserving capital and maintaining liquidity.”⁹⁷⁶ The commenter stated that permitted investments include, among other things, U.S. Treasury securities, and investments with U.S. Treasury securities may be made by either direct purchase or sale or by entering into repo transactions.⁹⁷⁷ The commenter further explained that, for repo transactions, an FCM’s “permitted counterparties are limited to a bank ..., securities broker-dealer, or government securities dealer registered with the [Commission],” and a clearing agency is not a permitted counterparty.⁹⁷⁸ If an FCM is unable to clear repo transactions then it would not be able to trade with FICC netting members, reducing the number of potential counterparties available to it.

c. Other Changes to Covered Clearing Agency Standards

i. Netting and Margin Practices for House and Customer Accounts

The amendments to Rule 17ad-22(e)(6)(i) require a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin amounts from a direct participant for its proprietary U.S. Treasury securities positions, separately and independently from margin

⁹⁷⁶ FIA Letter, *supra* note 200, at 4-5 (discussing 17 CFR 1.25(b)).

⁹⁷⁷ FIA Letter, *supra* note 200, at 4-5 (discussing 17 CFR 1.25(a)).

⁹⁷⁸ FIA Letter, *supra* note 200, at 5 (discussing 17 CFR 1.25(d)(2)).

calculated and collected from that direct participant in connection with U.S. Treasury securities transactions by an indirect participant that relies on the services provided by the direct participant to access the covered clearing agency's payment, clearing, or settlement facilities.⁹⁷⁹ The amendments to Rule 17ad-22(e)(6)(i) contain similar provisions to existing FICC rules, specifically with respect to its Sponsored Member program, but also impose additional requirements that do not appear in existing Rule 17ad-22. As a result, the Commission believes that a U.S. Treasury securities CCA will incur burdens of reviewing and updating existing policies and procedures in order to comply with the amendments to Rule 17ad-22(e)(6) and, in some cases, may need to create new policies and procedures.⁹⁸⁰

The Commission estimates that U.S. Treasury securities CCAs will incur an aggregate one-time cost of approximately \$106,850 to create new policies and procedures.⁹⁸¹ The amendments to the rule also require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. The Commission estimates that the ongoing activities required by the amendments to Rule 17ad-22(e)(6) will impose an aggregate ongoing cost on covered clearing agencies of approximately \$60,580 per year.⁹⁸²

⁹⁷⁹ See part II.B.1 *supra*.

⁹⁸⁰ For general information and statistics regarding the Sponsored Service, see DTCC, *Sponsored Service*, *supra* note 669. The Sponsored Service also allows the submission of cash transactions; however, at this time, the service is generally used only for U.S. Treasury repo transactions.

⁹⁸¹ This figure was calculated as follows: Assistant General Counsel for 20 hours (at \$518 per hour) + Compliance Attorney for 40 hours (at \$406 per hour) + Computer Operations Manager for 12 hours (at \$490 per hour) + Senior Programmer for 20 hours (at \$368 per hour) + Senior Risk Management Specialist for 25 hours (at \$397 per hour) + Senior Business Analyst for 12 hours (at \$305 per hour) = \$53,425 x 2 respondent clearing agencies = \$106,850. See part V.B *infra*.

⁹⁸² This figure was calculated as follows: Compliance Attorney for 25 hours (at \$406 per hour) + Business Risk Analyst for 40 hours (at \$305 per hour) + Senior Risk Management Specialist for 20 hours (at \$397 per hour) = \$30,290 x 2 respondent clearing agencies = \$60,580. See part V.B *infra*.

ii. Facilitating Access to U.S. Treasury Securities CCAs

Rule 17ad-22(e)(18)(iv)(C) requires a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, 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, which policies and procedures the U.S. Treasury securities CCA's board of directors reviews annually.

The rule requires a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures. The Commission believes that a respondent U.S. Treasury securities CCA will incur burdens of reviewing and updating existing policies and procedures and will need to create new policies and procedures in order to comply with the provisions of Rule 17ad-22(e)(18)(iv)(C). These costs are included in the costs of creating new policies and procedures associated with Rule 17ad-22(e) discussed above.

Commenters generally supported the Commission's attention to the need for appropriate access to the U.S. Treasury securities CCA, and several commenters specifically agreed that the Commission should not prescribe any particular model. One commenter stated that the commenter "fully agree[s] with the Commission that flexibility and an open-access approach are critical to facilitating access to clearing. [], dictating a single model of clearing would close off clearing to many market participants, force indirect participants to bear additional clearing costs, increase concentration, reduce competition, and negatively impact market liquidity."⁹⁸³ In addition, another commenter supported the proposal to rely on the clearing agencies to develop the model and infrastructure and that clearing agencies should have flexibility to innovate in this area. This

⁹⁸³ FICC/DTCC Letter, *supra* note 33, at 18.

commenter also noted many market stakeholders may prefer an agency model or some form of limited membership with a clearing agency.⁹⁸⁴

Another commenter stated that the Commission should encourage FICC to improve the existing Sponsored Service in several ways: 1) to further develop a “give up” structure to facilitate best execution (and accommodate “done-away” trades), noting that FICC’s prime broker/correspondent clearing infrastructure could be leveraged to develop a give up model outside of prime brokerage (which would need to provide for standardized documentation that facilitates additions and deletions of approved brokers, agreed-upon terms for rejection of trades by a sponsoring member and centralized storage of delegations); and 2) to add a feature permitting (but not requiring) sponsored members to directly support their obligations to FICC through margin posting rather than by paying fees to the sponsoring member reflecting the cost of its clearing fund contributions.⁹⁸⁵ As stated in the Proposing Release, the Commission believes that U.S. Treasury securities CCAs should continue to develop access models that would best serve the needs of market participants, and the Commission encourages such CCAs to take all appropriate steps to accommodate “done-away” trades. The Commission would consider any proposals in this regard consistent with its obligations under Section 19 of the Exchange Act.

d. Amendments to Rules 15c3-3 and 15c3-3a

The amendment to Rule 15c3-3a permits, under certain conditions, margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula. This new debit item 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 U.S. Treasury securities CCA.

⁹⁸⁴ ICE Letter, *supra* note 85, at 3.

⁹⁸⁵ ICI Letter, *supra* note 85.

The amendment allows a customer's broker to use customer funds to meet margin requirements at the CCP generated by the customer's trades, lowering the cost of providing clearing services.

Broker-dealers may incur costs from updating procedures and systems to be able to use customer funds to meet customer margin requirements. However, the amended rule does not require that the broker-dealer does so.

Overall, commenters supported the proposal to permit this debit item.⁹⁸⁶ Commenters stated that the proposed amendments would make clearing more efficient and free up resources that could be used to meet the CCA's margin requirements, while continuing to protect customer funds.⁹⁸⁷ Commenters also stated that the proposal would incentivize central clearing.⁹⁸⁸ A commenter stated that the proposal would extend to margin held at a U.S. Treasury securities CCA the same treatment as margin posted to other clearing organizations.⁹⁸⁹ As a result, this commenter stated that the proposal would facilitate greater access to clearing and eliminate an undue burden on competition. Another commenter—in supporting the proposal—stated that it does not make sense that margin cannot be freely rehypothecated from a customer through a broker-dealer to a U.S. Treasury securities CCA without the broker-dealer receiving a beneficial adjustment as part of its customer reserve formula calculation.⁹⁹⁰ For greater and more efficient client clearing, another commenter encouraged the Commission to adopt this proposal irrespective of whether the requirement to clear eligible secondary market transactions is adopted.⁹⁹¹

⁹⁸⁶ See AIMA Letter, *supra* note 81; CME Letter, *supra* note 81; DTCC/FICC Letter, *supra* note 33; ICE Letter, *supra* note 33; MFA Letter, *supra* note 81; ISDA Letter, *supra* note 391; SIFMA AMG Letter, *supra* note 35.

⁹⁸⁷ See AIMA Letter, *supra* note 81; MFA Letter, *supra* note 81; SIFMA/IIB Letter *supra* note 37.

⁹⁸⁸ See CME Letter, *supra* note 81; SIFMA AMG Letter, *supra* note 35.

⁹⁸⁹ See DTCC/FICC Letter, *supra* note 33.

⁹⁹⁰ See SIFMA AMG Letter, *supra* note 35.

⁹⁹¹ See ISDA Letter, *supra* note 391.

One commenter sought clarification that the conditions of Rule 15c3-3 would not preclude a U.S. Treasury securities CCA from entering into a repurchase transaction involving customer cash margin, so long as the purchased securities under such repurchase transaction consist of U.S. Treasury securities held in a segregated account for the benefit of customers and satisfy certain other requirements.⁹⁹² The commenter provided a summary of potential protections that could be put in place to ensure that—if a U.S. Treasury securities CCA uses cash in the broker-dealer’s segregated account for liquidity purposes—the cash would be protected through collateral comprising U.S. Treasury securities deposited into the account and other measures.⁹⁹³ As discussed in part II.C.4.iii, *supra* the Commission would need to review a more detailed plan for how the cash will be used and customers protected before taking any action on the commenter’s request. The Commission acknowledges that the degree to which costs that are incurred in order to maintain sufficient qualifying liquid resources are directly born by various participants depends in part on the use of customer margin as a qualifying liquid resource.⁹⁹⁴

e. Other Costs

One commenter stated that the Commission should consider that “the sheer number and complexity of the Proposals, when considered in their totality, if adopted, would impose staggering aggregate costs, as well as unprecedented operational and other practical challenges.”⁹⁹⁵ But, consistent with its long-standing practice, the Commission’s economic analysis in each adopting

⁹⁹² DTCC/FICC Letter II, *supra* note 503. *See also* part II.C.4.iii, *supra* for additional discussion of the issue raised by this comment letter.

⁹⁹³ *Id.*

⁹⁹⁴ One such source is FICC’s CCLF. *See* part IV.B.4, *supra* and part IV.C.2.a.i, *supra*. *See also supra* note 688, and referencing text regarding the Commission’s requiring FICC to hold qualifying liquid resources sufficient to meet a cover-1 standard.

⁹⁹⁵ MFA Letter 2, *supra* note 600, at 3; *see* ICI Letter 2, *supra* note 600, at 3 (stating that the Commission should consider “practical realities such as the implementation timelines as well as operational and compliance requirements”).

release considers the incremental benefits and costs for the specific rule—that is the benefits and costs stemming from that rule compared to the baseline. In doing so, the Commission acknowledges that in some cases resource limitations can lead to higher compliance costs when the compliance period of the rule being considered overlaps with the compliance period of other rules. In determining compliance periods, the Commission considers the benefits of the rules as well as the costs of delayed compliance periods and potential overlapping compliance periods.

In this regard, some commenters mentioned the proposals which culminated in the recent adoptions of the May 2023 SEC Form PF Amending Release, the Beneficial Ownership Amending Release, the Private Fund Advisers Adopting Release, the Rule 10c-1a Adopting Release, the Short Position Reporting Adopting Release, and the Securitizations Conflicts Adopting Release.⁹⁹⁶ The Commission acknowledges that there are compliance periods for certain requirements of these rules that overlap in time with the final rule, which may impose costs on resource constrained entities affected by multiple rules.⁹⁹⁷

However, the Commission does not think these increased costs from overlapping compliance periods will be significant for several reasons. First, the number of market participants who directly or indirectly engage in eligible secondary market transactions in Treasury securities that will be subject to the final rule and who will be subject to one or more of the other recently adopted rules could be limited based on whether those participants' activities fall within the scope

⁹⁹⁶ See *supra* note 600. As stated above, commenters also specifically suggested the Commission consider potential overlapping compliance costs between the final rule and certain proposing releases. See *supra* note 608. These proposals have not been adopted and thus have not been considered as part of the baseline here. To the extent those proposals are adopted in the future, the baseline in those subsequent rulemakings will reflect the regulatory landscape that is current at that time.

⁹⁹⁷ See *supra* notes 602 to 607 (summarizing compliance dates).

of the other rules.⁹⁹⁸ Second, for the reasons discussed above, we have adopted a phased approach to implementation and compliance based on input from commenters.⁹⁹⁹ Further, all of the other rules have long compliance periods, which is expected to facilitate planning, preparation and investment and thereby limit the cost of overlapping compliance periods.¹⁰⁰⁰ Third, commenters' concerns about the costs of overlapping compliance periods were raised in response to the proposal and as discussed above, we have taken steps to reduce costs of the final rule.¹⁰⁰¹

3. Effect on Efficiency, Competition, and Capital Formation

a. **Efficiency**

i. **Price Transparency**

As mentioned in part IV.B *supra*, the majority of trading in on-the-run U.S. Treasury securities in the interdealer market occurs on electronic platforms operated by IDBs that bring together buyers and sellers anonymously using order books or other trading facilities supported by advanced electronic trading technology. These platforms are usually run independently in the sense that there is no centralized market for price discovery or even a “single virtual market with

⁹⁹⁸ The Rule 10c-1a Adopting Release will require only persons who agree to a covered securities loan to report that activity. The Short Position Reporting Adopting Release will require only institutional investment managers that meet or exceed certain reporting thresholds to report short position and short activity data for equity securities. And the Securitizations Conflicts Adopting Release will affect only certain entities—and their affiliates and subsidiaries—that participate in securitization transactions. *See supra* notes 605 to 607. In addition, FICC will not be affected by any of the six rules identified by commenters.

⁹⁹⁹ *See* part III *supra*.

¹⁰⁰⁰ *See supra* notes 602 to 607.

¹⁰⁰¹ The final rule mitigates costs relative to the proposal in the following ways. First, the scope of the definition of eligible secondary market transaction in Rule 17ad-22(a) has been revised to exclude repos by other clearing organizations, repos by state and local governments, and inter-affiliate repos. Second, the scope of the definition of eligible secondary market transaction has been modified to no longer include cash transactions by hedge funds and leveraged accounts. Third, the Commission is modifying paragraph (a) of Note H to Rule 15c3-3a to permit “qualified customer securities” to be used to meet the customer position margin requirement in addition to cash and U.S. Treasury securities. Finally, to reduce operational burdens on broker-dealers, the Commission is removing the proposed requirement to return excess collateral within one business day that was part of fifth rule set—identified in paragraph (b)(2)(v) of proposed Note H.

multiple points of entry”.¹⁰⁰² As a result, pre-trade transparency is suboptimal: quotations and prices coming from and going to an IDB may be distributed unevenly to market participants who have a relationship with that IDB. Efficiency, which measures the degree to which prices can quickly respond to relevant information, is impaired because of this market fragmentation; some areas of the market may not reflect information passed on by prices in other sectors. Central clearing can promote price discovery in several ways: first, the clearing agency itself becomes a source of data;¹⁰⁰³ and second, the accessibility of central clearing could promote all-to-all trading as previously mentioned in part II.A.1 *supra*, which should reduce the obstacles to information flow that come from fragmentation.¹⁰⁰⁴

ii. Operational and Balance Sheet Efficiency

Greater use of central clearing could also increase the operational efficiency of trading U.S. Treasury securities. Central clearing replaces a complex web of bilateral clearing relationships with a single relationship to the CCP. In that sense, the complex network of relationships that a market participant may have for bilaterally clearing U.S. Treasury securities would shrink, with attendant reductions in paperwork, administrative costs, and operational risk.

Central clearing also enhances balance sheet efficiency, allowing firms to put capital to more productive uses. The amendments to Rule 15c3-3a permit, under certain conditions, margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula. This new debit item 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 U.S.

¹⁰⁰² Maureen O’Hara and Mao Ye, *Is Market Fragmentation Harming Market Quality?*, 100 J. FIN. ECON. 459 (2011).

¹⁰⁰³ FIA-PTG Whitepaper, *supra* note 918.

¹⁰⁰⁴ *See supra* note 31.

Treasury securities CCA. The amendment allows a customer’s broker to use customer funds to meet margin requirements at the CCP generated by the customer’s trades, lowering the cost of providing clearing services. Though these lower costs may or may not be fully passed on to customers, in a competitive environment the Commission expects that at least some of these savings will pass through to customers.

b. Competition

With respect to the market for execution of U.S. Treasury securities by broker-dealers, increased central clearing can enhance the ability of smaller participants to compete with incumbent dealers.¹⁰⁰⁵ Similarly, decreased counterparty credit risk – and potentially lower costs for intermediation – could result in narrower spreads, thereby enhancing market quality.¹⁰⁰⁶ While estimating this quantitatively is difficult, research has demonstrated lower costs associated with central clearing in other settings.¹⁰⁰⁷ Moreover, increased accessibility of central clearing in U.S. Treasury securities markets could support all-to-all trading, which should further improve competitive pricing, market structure and resiliency.¹⁰⁰⁸

Commenters suggest that costs of clearing may be disproportionately felt by small and mid-size participants in the Treasury market.¹⁰⁰⁹ An additional commenter stated that the proposed separation of house and customer margin would negatively impact small and mid-size broker-dealers who are disproportionately affected by FICC’s Excess Capital Premium (“ECP”) charge, which is a margin add-on that collects a premium when a member’s VaR charge exceeds the

¹⁰⁰⁵ See G-30 Report, *supra* note 5, at 13.

¹⁰⁰⁶ *Id.*

¹⁰⁰⁷ See Y.C. Loon & Z.K. Zhong, *The Impact of Central Clearing on Counterparty Risk, Liquidity, and Trading: Evidence From the Credit Default Swap Market*, 112 J. FIN. ECON. 91 (2014).

¹⁰⁰⁸ See 2021 IAWG Report, *supra* note 4, at 30; Duffie, *supra* note 27, at 16; G-30 Report, *supra* note 5, at 13.

¹⁰⁰⁹ Letter from Evan Gerhard, President and CEO of ASL Capital Markets (Dec. 23, 2022) and letter from SIA Partners (Aug. 31, 2023) at 22 (“SIA Partners 2”).

member's Net Capital, net assets or equity capital (as applicable to that member based on its type of regulation).¹⁰¹⁰ The commenter explained the impact of the ECP charge in conjunction with FICC's Sponsored Service, stating that "the combination of gross margining and ECP currently in use under the Sponsored Model, and what is prescribed in the Proposed Rule, effectively prevents smaller and middle market broker dealers from materially participating in the Treasury market."¹⁰¹¹ The commenter states that the ultimate effect of the ECP charge is exacerbated when customer/institutional counterparty margin is included in the calculation, and the surcharge prevents smaller independent broker-dealers from sponsoring institutional counterparties/customers.¹⁰¹² The commenter's concerns regarding the interplay between purported required gross margining and the ECP charge rests on the assumption that gross margin is required under the proposal, which, as discussed in part II.B.1 *supra*, is not the case.¹⁰¹³ With respect to the ECP charge on its own, the Commission is not taking any action with respect to the ECP charge as part of adopting these new requirements. The ECP charge is part of FICC's existing rulebook, which is an SRO rule, and any change to that rulebook would be made pursuant to the proposed rule change process under Section 19(b).¹⁰¹⁴

While the rule does not require gross margining of customers, the rule does require members to clear additional transactions relative to the baseline. Because the dominant clearing model is the sponsored model, and because the sponsored model does use gross margining, which

¹⁰¹⁰ IDTA Letter, *supra* note 66, at 4; *see also* FICC Rule 4, section 14, *supra* note 19.

¹⁰¹¹ IDTA Letter, *supra* note 66, at 5.

¹⁰¹² IDTA Letter, *supra* note 66, at 5.

¹⁰¹³ The rule does require that a proprietary position not be netted against a customer position. This could enhance competition because dealers with customers are no longer advantaged relative to those without. It enhances the unbundling of clearing and trading services described in part IV.C.1 *supra*.

¹⁰¹⁴ Exchange Act Section 19(b); *see also* Section 19(c).

implicates the ECP, the Commission acknowledges the commenter's concerns regarding possible competitive effects on the Treasury market. Specifically, the existence of the ECP links the costs of sponsorship with the capital of the entity, and hence sponsorship is more economical for some than for others. Because current market practice is to bundle execution with clearing, some entities may face additional hurdles in trade execution in that it may be uneconomical for them to serve as sponsoring members for a large dollar value of trades.

There are two factors that mitigate any potential impact of the ECP on competitiveness. First, there are alternatives to the sponsored clearing model that do not require gross margining. The commenter cites one such model, and notes ambiguity as to whether this model can indeed be used by independent dealers.¹⁰¹⁵ The Commission acknowledges the commenter's concern but notes that FICC recently has indicated that it intends to make available client clearing models that do not require gross margin, consistent with its current offerings.¹⁰¹⁶ Second, the amendments to Rule 15c3-3a, which permit margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula makes it economical for dealers to post margin on behalf of their customers. This may encourage the development of clearing models that are based on counterparty risk, rather than the capital of the trading entity. In a second letter, the same commenter advocates for a common margining regime for FICC, where members participating in the MBSD, GSD, or the CME are accounted for properly in terms of offsetting

¹⁰¹⁵ See IDTA Letter, *supra* note 66, at 7.

¹⁰¹⁶ See DTCC 2023 White Paper, *supra* note 107, at 6 (discussing that the proposal would allow the option to calculate and collect margin associated with customer activity on a gross or net basis depending on the client clearing model selected by the member and stating that FICC would offer options via different access models that would allow those parties to balance the benefits of netting and segregation in different ways).

positions¹⁰¹⁷ and while that subject is not within the scope of this release, permitting rehypothecation of margin may have directionally similar effects.

With respect to the market for U.S. Treasury securities clearing services, currently there is a single provider of central clearing. The amendments will likely engender indirect costs associated with increased levels of central clearing in the secondary market for U.S. Treasury securities. Generally, the economic characteristics of a financial market infrastructure (“FMI”), including clearing agencies, include specialization, economies of scale, barriers to entry, and a limited number of competitors.^{1018, 1019} The Commission noted in its proposal of rules applicable to covered clearing agencies that such characteristics, coupled with the particulars of an FMI’s legal mandate, could result in market power, leading to lower levels of service, higher prices, and under-investment in risk management systems.¹⁰²⁰ Market power may also affect the allocation of benefits and costs flowing from these new rules and amendments that are being adopted, namely the extent to which these benefits and costs are passed through by FICC to participants.¹⁰²¹ The centralization of clearing activities for a particular class of transaction in a single clearing agency may also result in a reduction in its incentives to innovate and to invest in the development of appropriate risk management practices on an ongoing basis.

¹⁰¹⁷ IDTA Letter 2, *supra* note 829, at 2.

¹⁰¹⁸ See Comm. on Payment and Settlement Sys. and Tech. Comm. Int’l Org. Sec. Comms, *Principles for Financial Market Infrastructures* (Apr. 16, 2012), available at <https://www.bis.org/cpmi/publ/d101a.pdf>.

¹⁰¹⁹ See generally Nadia Linciano et al., *The Clearing and Settlement Industry: Structure Competition and Regulatory Issues* (Italian Secs. & Exch. Comm’n Research Paper 58, May 2005), available at <https://www.ssrn.com/abstract=777508> (concluding in part that the core services offered by the clearance and settlement industry tend toward natural monopolies because the industry can be characterized as a network industry, where consumers buy systems rather than single goods, consumption externalities exist, costs lock-in consumers once they choose a system, and production improves with economies of scale).

¹⁰²⁰ See CCA Standards Proposing Release, *supra* note 8. See also ICE Letter, *supra* note 31, at 2.

¹⁰²¹ For a discussion of cost pass-through, including when there lacks competition, see for example, RBB ECON., COST PASS-THROUGH: THEORY, MEASUREMENT AND POLICY IMPLICATIONS, A REPORT PREPARED FOR THE OFFICE OF FAIR TRADING (2014), available at <https://www.gov.uk/government/publications/cost-pass-through-theory-measurement-and-policy-implications>.

Finally, the scope of the rule does not preclude members of FICC from strategically renouncing membership if they assess that the benefits of maintaining their ability to trade without centrally clearing their trades exceed their costs of surrendering their membership with the CCA. If this scenario materializes for a number of FICC members, then there will be costs to the overall market. Those costs could be the product of a smaller number of clearing members competing in the market for clearing services. Costs could also manifest themselves as increased risk from non-centrally cleared transactions and a reduction in the margin, operational and capital efficiencies related to central clearing. Further, if the number of clearing members falls, then the exposure of FICC to its largest clearing member could increase resulting in additional increases in the required size of the CCLF.

In addition, as stated above, some commenters requested the Commission consider interactions between the economic effects of the proposed rule and other recent Commission rules, as well as practical realities such as implementation timelines.¹⁰²² As discussed above, the Commission acknowledges that overlapping compliance periods may in some cases increase costs. This may be particularly true for smaller entities with more limited compliance resources. This effect can negatively impact competition because these entities may be less able to absorb or pass on these additional costs, making it more difficult for them to remain in business or compete. However, we have mitigated the overall costs of the final rules relative to the proposal.¹⁰²³ Moreover, all of the other rules have long compliance periods to facilitate planning, preparation and investment, thereby mitigating the cost to smaller entities of overlapping compliance

¹⁰²² See parts IV.B, *supra*.

¹⁰²³ See *supra* note 1001.

periods.¹⁰²⁴ We therefore do not expect the risk of negative competitive effects from increased compliance costs from simultaneous compliance periods to be significant.

c. Capital Formation

The new rule and amendments may encourage private-sector capital formation. U.S. Treasury securities form a benchmark for fixed income and even equity rates of return, and the new rule could lower the cost of capital for private-sector issuers.¹⁰²⁵ If the yield required by investors to hold U.S. Treasury securities reflects, in part, the risks associated with the buying and selling of U.S. Treasury securities, and increased central clearing of these transactions lowers those risks, then the new rule may put downward pressure on required yields.

Research has shown that investors value both the safety and liquidity of U.S. Treasury securities. Because prices in the primary market both reflect and are driven by prices in the secondary market, liquidity could be one of the factors translating into lower rates of borrowing costs for U.S. taxpayers.¹⁰²⁶

¹⁰²⁴ See *supra* notes 604 to 607.

¹⁰²⁵ Standard textbook treatments of finance use the U.S. Treasury rate of return as a benchmark in computing the cost of capital for private companies. The link between interest rates of government debt and corporate debt is a long-standing feature of the financial landscape. See, e.g., Benjamin Friedman, *Implications of Government Deficits for Interest Rates, Equity Returns, and Corporate Financing*, FIN. CORP. CAP. FORM. (1986). See also Philippon, *The Bond Market's Q*, Q. J. ECON. (Aug. 2009) (noting a link between the level of interest rates and investment).

¹⁰²⁶ See Arvind Krishnamurthy & Annette Vissing-Jorgensen, *The Aggregate Demand for Treasury Debt*, 120 J. POL. ECON. (Apr. 2012).

D. Reasonable Alternatives

1. Require U.S. Treasury Securities CCAs to Have Policies and Procedures Requiring Only IDB Clearing Members to Submit U.S. Treasury Securities Cash Trades with Non-members for Central Clearing

In the Proposing Release, the Commission considered the alternative of narrowing the scope of the requirement to clear eligible secondary market transactions as it pertains to cash transactions in the secondary market for U.S. Treasury securities. The narrower definition of eligible secondary market transaction contemplated in this alternative included (1) a repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities, in which one of the counterparties is a direct participant; or (2) a purchase or sale between a direct participant and any counterparty, if the direct participant of the covered clearing agency (A) brings together multiple buyers and sellers using a trading facility (such as a limit order book) and (B) is a counterparty to both the buyer and seller in two separate transactions.¹⁰²⁷ This alternative differs from the proposal by omitting from the definition of eligible transactions those cash transactions between a direct participant and a registered broker-dealer, government securities broker, government securities dealer, hedge fund, or account at a registered broker-dealer, government securities

¹⁰²⁷ See Proposing Release. Such direct participants are referred to in this section and the alternatives below as “IDBs”.

dealer, or government securities broker where such account may borrow an amount in excess of one-half of its net assets or may have gross notional exposure in excess of twice its net assets.¹⁰²⁸

Several commenters supported the Commission’s proposal overall, including the cash clearing requirement.¹⁰²⁹ By contrast, other commenters opposed cash clearing generally.¹⁰³⁰ Other commenters suggested that the scope of eligible secondary market transactions in the cash market be broadened.¹⁰³¹

As discussed in the proposing release, the benefits arising from cash clearing for IDB members are particularly high. Hybrid clearing creates unique issues for FICC because FICC is able to manage the risks arising from the IDB-FICC member trade, but it lacks any knowledge of the IDB’s offsetting trade with its other counterparty and the potential exposure arising to the IDB from that trade, leaving the IDB, from FICC’s perspective, as apparently having a directional exposure despite the non-centrally cleared trade that would leave the IDB flat.¹⁰³² This lack of knowledge could prevent FICC from “accurately identifying, measuring and managing its direct and indirect counterparty risk exposure and can affect its decision-making,”¹⁰³³ which in turn potentially increases the likelihood that a default of an IDB member could in turn harm the CCP or the system as a whole. As stated in the Proposing Release, the Commission has previously stated that membership requirements help to guard against defaults of any CCP member, as well to

¹⁰²⁸ See Proposing Release, *supra* note 14, 88 FR at 64663; *see also id.* at 64622 for a discussion of cash transactions included in the definition of eligible transactions.

¹⁰²⁹ AFREF Letter, *supra* note 33, at 2; Better Markets Letter, *supra* note 33, at 2, 6-8.

¹⁰³⁰ See part II.A.2.b *supra* for a discussion of comments received regarding cash clearing.

¹⁰³¹ *Id.*

¹⁰³² See TMPG White Paper, *supra* note 13 at 22 (noting that in a hybrid clearing arrangement, an “IDB’s rights and obligations vis-a-vis the CCP are not offset and therefore the IDB is not in a net zero settlement position with respect to the CCP at settlement date.”).

¹⁰³³ See TMPG White Paper, *supra* note 13, at 27.

protect the CCP and the financial system as a whole from the risk that one member's default could cause others to default, potentially including the CCP itself. Further, contagion stemming from a CCP member default could be problematic for the system as a whole, even if the health of the CCP is not implicated. The default could cause others to back away from participating in the market, particularly if the defaulting participant was an IDB, whose withdrawal from the market could jeopardize other market participants' ability to access the market for U.S. Treasury securities.¹⁰³⁴

This alternative would, with a more limited scope, move a large portion of secondary market transactions in U.S. Treasury securities that are not currently centrally cleared into central clearing.¹⁰³⁵ The degree of central clearing would still allow for a partial picture of concentrated positions to the clearing agency. That said, there would be a limited benefit in terms of operational and balance sheet efficiency, and the benefits other than those specifically related to the IDB would be greatly reduced. Specifically, the reduced scope of this alternative would not capture types of participants that are usually leveraged such as hedge funds.

As discussed in part II.A.2.b *supra*, the Commission is not including transactions with hedge funds and leveraged accounts in the definition of eligible transactions. The definition of eligible secondary market transaction in Rule 17ad-22(a) is being adopted as proposed with respect to IDB transactions and transactions that involve a purchase or sale between a direct participant and a registered broker-dealer, government securities broker, or government securities dealer. Including these transactions within the scope of eligible transactions increases the benefits discussed above associated with an increased proportion of transactions being centrally cleared.¹⁰³⁶

¹⁰³⁴ See TMPG White Paper, *supra* note 13, at 32.

¹⁰³⁵ *Id.*

¹⁰³⁶ See Proposing Release, *supra* note 14, and part IV.A, *supra* of this release for a discussion of the benefits associated with increased central clearing.

However, as discussed above, the costs associated with including these transactions within the scope of eligible transactions may be less than those transactions not included by this alternative.¹⁰³⁷

2. Require U.S. Treasury Securities CCAs to Have Policies and Procedures Requiring the Submission of All Repurchase Agreements without Requirements for the Submission of Cash Transactions

In the Proposing Release, the Commission considered excluding the cash U.S. Treasury securities market from the proposed rule, and instead only requiring that covered clearing agencies have policies and procedures reasonably designed to require that direct participants of the covered clearing agency submit for central clearing all transactions in U.S. Treasury repo transactions into which it enters.¹⁰³⁸

Several commenters supported the Commission's proposal overall, including the cash clearing requirement.¹⁰³⁹ By contrast, other commenters opposed cash clearing generally.¹⁰⁴⁰

The Commission understands that there is a likely benefit of additional balance sheet capacity that flows from clearing repo transactions in U.S. Treasury securities that might not occur with the clearing of cash transactions. Multilateral netting can reduce the amount of balance sheet capacity required for intermediation of repo and could enhance dealer capacity to make markets during normal times and stress events, because existing bank capital and leverage requirements

¹⁰³⁷ See Proposing Release, *supra* note 14, at 64665 for a discussion of the familiarity of many registered brokers with methods of central clearing of U.S. Treasury securities transactions. See also Id at 64669 for a discussion of the costs to non-FICC members, including the entities included within this alternative, of the requirement to clear eligible secondary market transactions.

¹⁰³⁸ See Proposing Release, *supra* note 14.

¹⁰³⁹ AFREF Letter, *supra* note 33, at 2; Better Markets Letter, *supra* note 33, at 2, 6-8.

¹⁰⁴⁰ See part II.A.2.b *supra* for a discussion of comments received regarding cash clearing.

recognize the risk-reducing effects of multilateral netting of trades that CCP clearing accomplishes.¹⁰⁴¹

The upfront costs of adjusting to the rule would be lower under this alternative than under the current proposal, as a result of a smaller number of participants and activities in scope and also the current level of interconnectedness among those participants. As previously mentioned, the number of participants in the U.S. Treasury repo market is significantly smaller than the number of participants in the cash market and is composed of sophisticated investors who have already incurred the costs of building the ability to novate transactions to the CCP. Infrastructure for Sponsored Clearing already exists, so processing changes should be less than in other more comprehensive alternatives and costs would be concentrated on the implementation of similar agreements at a larger scale.

Nevertheless, excluding the cash U.S. Treasury securities market from the rule would omit the largest sector of the U.S. Treasury market, both in terms of activity and number of participants. This alternative would yield smaller benefits in the areas of financial stability, risk visibility, margin offset efficiencies, and capital requirement reductions. The Commission believes that, given the scale-intensive nature of clearing, there are economies of scale that can only be realized when a larger number of financial market participants clear their U.S. Treasury securities cash trades.

¹⁰⁴¹ See 2021 IAWG Report, *supra* note 4; Liang & Parkinson, *supra* note 725, at 9; Duffie, *supra* note 27, at 16-17.

3. Include All Cash Transactions within the Scope of Eligible Secondary Market Transactions with Exceptions for Central Banks, Sovereign Entities, International Financial Institutions, and Natural Persons

In the Proposing Release, the Commission considered requiring covered clearing agencies to have policies and procedures reasonably designed to require that direct participants of the covered clearing agency submit for central clearing all cash and repo transactions in U.S. Treasury securities into which they enter, except for natural persons, central banks, sovereign entities and international finance institutions. This policy option would include cash transactions between direct participants of a U.S. Treasury securities CCA and any counterparty except for those that fall within one of the aforementioned exceptions.¹⁰⁴² Several commenters opposed cash clearing generally.¹⁰⁴³

This alternative would capture more of the potential benefits and positive externalities that result from increased central clearing, more closely resembling the assumptions and estimated benefits of Fleming and Keane's calculations on clearing benefits.¹⁰⁴⁴ By virtue of requiring all repo and most cash transactions to be centrally cleared, the alternative goes the furthest in solving the underlying collective action problem whereby some participants may find it optimal to not participate in central clearing, reducing the benefits that may accrue to the market as a whole.

Several commenters suggested that the scope of eligible secondary market transactions in the cash market be broadened. One commenter stated that the Commission should align the scope of the definition with respect to cash transactions with the proposed scope for repos, subject to certain limited exceptions for investors that trade de minimis volumes. The commenter argued that

¹⁰⁴² See Proposing Release, *supra* note 14.

¹⁰⁴³ See part II.A.2.b *supra* for a discussion of comments received regarding cash clearing.

¹⁰⁴⁴ Fleming & Keane (2021), *supra* note 796.

the Commission's approach with respect to cash transactions will increase costs for a specific subset of market participants, thereby putting them at a competitive disadvantage, while failing to deliver the envisaged market-wide benefits associated with central clearing (*i.e.*, it would materially reduce the associated multilateral netting benefits, impair the risk management practices of clearing agencies, and hinder the evolution in trading protocols that can be expected from a market-wide clearing requirement).¹⁰⁴⁵ For similar reasons, another commenter also stated that the benefits of central clearing detailed will only materialize if "a market-wide mandate is implemented" and supported defining the scope of eligible secondary market transactions for cash transactions as broadly as that proposed for repos.¹⁰⁴⁶ Another commenter stated that limiting the scope of the cash clearing mandate would result in unwarranted competitive disadvantages and related market distortions for some types of investors, such as hedge funds, or some types of trading platforms, such as anonymous trading facilities.¹⁰⁴⁷ An additional commenter stated that the proposed definition leaves out other important market participants' cash Treasury transactions that also comprise a large segment of Treasury market liquidity, and that the Commission should require other market participants' cash Treasury transactions in which a direct participant is involved to be cleared, so that the benefits of central clearing that the Commission cites will accrue throughout the broader cash Treasury market.¹⁰⁴⁸ In addition, another commenter acknowledged the benefits of a comprehensive clearing requirement, but acknowledged the need for a pragmatic

¹⁰⁴⁵ Citadel Letter, *supra* note 81, at 5.

¹⁰⁴⁶ ARB et al. Letter, *supra* note 81, at 4 (stating that the netting benefits associated with transitioning only proprietary trading firm ("PTF") transactions into central clearing are much smaller, given the substantial netting that already occurs directly with inter-dealer brokers ("IDBs"); the trading-related benefits of central clearing will only accrue to market participants if their transactions are covered by the proposed mandate; and that clearing agency resiliency will be negatively impacted if only one segment of the market is cleared).

¹⁰⁴⁷ MFA Letter, *supra* note 81, at 2.

¹⁰⁴⁸ AIMA Letter, *supra* note 81, at 7.

approach and supported the Commission's proposed requirements as a reasonable foundation to begin mandatory central clearing in this market.¹⁰⁴⁹

As discussed above, the benefits of clearing are scale-dependent, so that a more comprehensive clearing directive would result in larger positive externalities (*e.g.*, lower contagion risk, less financial network complexity) and larger economies of scale (*e.g.*, larger margin offsets) for the U.S. Treasury securities market. Another benefit of this alternative would be an enhanced ability of FICC (and, by extension, regulatory agencies) to observe the dynamics and manage the risks in the U.S. Treasury securities markets.

Nevertheless, there are compelling reasons for the exclusions that the proposal makes for a specific sample of market participants. Buy-side participants in the U.S. Treasury securities markets that do not take on any leverage, or take less than one-half their assets in leverage, such as the majority of bond mutual funds, typically have lower daily turnover. As a result of their lower turnover and subsequent lower volume, they typically do not have the existing infrastructure to readily connect to the CCP, making their up-front costs significantly higher than for other participants. This implies that the costs of subjecting these participants to the requirement to clear eligible secondary market transactions are likely higher than those of participants included in the proposal and the benefits smaller.

4. Require U.S. Treasury Securities CCAs to Change CCA Access Provisions and Netting and Margin Practices for House and Customer Accounts and Rule 15c3-3

In the Proposing Release the Commission considered, as an alternative to the policy choices it proposed, only amending Rules 15c3-3, 17ad-22(e)(6)(i), and 17ad-

¹⁰⁴⁹ GTS Letter, *supra* note 81, at 3-5.

22(e)(18)(iv)(C).¹⁰⁵⁰ This alternative would not include a requirement to clear eligible secondary market transactions, as set forth in Proposed Rule 17ad-22(e)(18)(iv)(A) and (B).¹⁰⁵¹

Overall, commenters supported the proposed amendments to Rule 15c3-3a.¹⁰⁵² For increased and more efficient client clearing, another commenter encouraged the Commission to adopt this proposal irrespective of whether the Commission adopts the requirement to clear eligible secondary market transactions, as set forth in Proposed Rule 17ad-22(e)(18)(iv)(A) and (B).¹⁰⁵³

This alternative would require a U.S. Treasury securities CCA to establish, implement, maintain and enforce certain written policies and procedures that would be reasonably designed to, as applicable, calculate, collect, and hold margin amounts from a direct participant for its proprietary U.S. Treasury securities positions separately and independently from margin that would be held for an indirect participant. Specifically, the requirement to separately and independently hold an indirect participant's margin would apply to margin calculated by and collected from a direct participant in connection with its U.S. Treasury securities transactions with an indirect participant that relies on the direct participant's services to access the covered clearing agency's payment, clearing, or settlement facilities.

The alternative would also include changes to 17ad-22(e)(18)(iv)(C), directing FICC to, as more fully described above, have policies and procedures, to be annually reviewed by its board of directors, to have appropriate means to facilitate access to clearing all eligible secondary market transactions in U.S. Treasury securities. This alternative would also include changes to Rule 15c3-

¹⁰⁵⁰ See Proposing Release, *supra* note 14.

¹⁰⁵¹ *Id.*

¹⁰⁵² See AIMA Letter, *supra* note 81, at 8; CME Letter, *supra* note 81, at 4; DTCC/FICC Letter, *supra* note 33, at 28-29; ICE Letter, *supra* note 33, at 3; MFA Letter, *supra* note 81, at 10; ISDA Letter, *supra* note 391, at 2; SIFMA AMG Letter, *supra* note 35, at 8. See part II.C *supra* for a discussion of comments received.

¹⁰⁵³ See ISDA Letter, *supra* note 391, at 2.

3a, to permit margin required and on deposit at a U.S. Treasury securities CCA to be included as a debit item in the customer reserve formula, subject to the conditions discussed below. 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 U.S. Treasury securities CCA. The new debit item would be reported on a newly created Item 15 of the Rule 15c3-3a reserve formula.

As discussed in part IV.C.2.b *supra*, the proposed amendments to Rule 17ad-22(e)(6)(i) should produce benefits for dealer-to-customer trades. Because margin for a direct participant's (*i.e.*, a dealer's) trades that have been novated to the CCP would be calculated, collected, and held separately and independently from those of an indirect participant, such as a customer, the direct participant's trades with the indirect participant that have been novated to the CCP would be able to be netted against the direct participant's position with other dealers. Such netting is not currently available. In summary, the Commission expects changes in the customer reserve formula and expanded margin offset possibilities to allow more efficient use of margin for cleared trades relative to current market practice.

As discussed in part II.A.1.a *supra*, commenters identified several methods by which the Commission could or should incentivize additional central clearing without adopting a requirement to clear eligible secondary market transactions. One of the methods commenters identified was to adopt Rule 15c3-3 discussed in part II.C *infra* as a method to incentivize additional central clearing.¹⁰⁵⁴ As discussed in part II.5 *supra* the Commission agrees that the methods identified by the commenters could incentivize and facilitate additional central clearing. The Commission therefore is adopting the amendments to Rule 15c3-3, the requirement to segregate house and customer margin, and the need to ensure access to central clearing, as discussed in parts II.C,

¹⁰⁵⁴ See *supra* note 344.

II.B.1, and II.B.2 *supra* respectively. The Commission does not believe that these changes should be made without also requiring that U.S. Treasury securities CCAs obligate their direct participants to submit eligible secondary market transactions for clearing. Merely incentivizing and facilitating greater central clearing, as opposed to requiring central clearing, would not sufficiently address the current risks to U.S. Treasury securities CCAs. Therefore, for the reasons discussed in part II.2.a and b, the requirement to clear is also necessary.

V. Paperwork Reduction Act

A. Proposed Changes to Covered Clearing Agency Standards

As discussed in the Proposing Release,¹⁰⁵⁵ the amendments to Rule 17ad-22(e) contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).¹⁰⁵⁶ The Commission submitted the proposed collections of information to the Office of Management and Budget (“OMB”) for review in accordance with the PRA. The title of the information collection for Rule 17ad-22(e) is “Clearing Agency Standards for Operation and Governance” (OMB Control No. 3235-0695). The amendments to Rule 17ad-22(e) add two new information collections, titled “17ad-22(e)(6) (Treasury Clearing)” and “17ad-22(e)(18) (Treasury Clearing),” respectively, to OMB Control No. 3235-0695. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Respondents under this rule are Treasury securities CCAs, of which there is currently one. The Commission anticipates that one additional entity may seek to register as a clearing agency to provide CCP services for Treasury securities in the next three years, and so for purposes of this

¹⁰⁵⁵ Proposing Release, *supra* note 14, 87 FR at 64675-77.

¹⁰⁵⁶ See 44 U.S.C. 3501 *et seq.*

rulemaking the Commission has assumed two respondents.

As described above in parts II.A and B *supra*, the Commission is adopting the amendments to Rules 17ad-22(e)(6) and (e)(18) as proposed, and the Commission has received no comments on the burden estimates provided in the Proposing Release. Accordingly, the Commission is not adjusting the burden estimates from the Proposing Release, except with respect to minor changes to correct mathematical errors, as described more fully below.

A. Amendment to Rule 17ad-22(e)(6)

The purpose of this collection of information is to enable a covered clearing agency for Treasury securities to better understand and manage the risks presented by transactions that a direct participant may submit on behalf of its customer, *i.e.*, an indirect participant which relies upon the direct participant to access the covered clearing agency. The collection is mandatory. To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential subject to the provisions of applicable law.¹⁰⁵⁷

The amendment to Rule 17ad-22(e)(6) requires a Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures. The amendment contains similar provisions to existing FICC rules, specifically with respect to its Sponsored Member program, but also imposes additional requirements that did not previously appear in Rule 17ad-22. As a result, the Commission believes that a respondent Treasury securities CCA will incur burdens of reviewing and updating existing policies and procedures in order to comply with the amendment

¹⁰⁵⁷ See, e.g., 5 U.S.C. 552. Exemption 4 of the Freedom of Information Act provides an exemption for trade secrets and commercial or financial information obtained from a person and privileged or confidential. See 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. See 5 U.S.C. 552(b)(8).

to Rule 17ad-22(e)(6) and, in some cases, may need to create new policies and procedures.¹⁰⁵⁸ The Commission believes that the PRA burdens for the amendment to Rule 17ad-22(e)(6) may require a respondent clearing agency to make substantial changes to its policies and procedures. Based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for several rules in the Covered Clearing Agency Standards where the Commission anticipated similar burdens,¹⁰⁵⁹ the Commission estimates that the amendment to Rule 17ad-22(e)(6) would impose on each respondent Treasury securities CCA an initial burden of 129 hours in the first year.¹⁰⁶⁰

In addition, the amendment to Rule 17ad-22(e)(6) imposes ongoing burdens on a respondent Treasury securities CCA. The amended rule requires ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the amended rule. Based on the similar reporting requirements and the corresponding burden estimates previously made by the Commission for several rules in the Covered Clearing Agency Standards where the Commission anticipated similar burdens,¹⁰⁶¹ the Commission estimates that the ongoing activities required by the amendment to Rule 17ad-22(e)(6) would impose an ongoing

¹⁰⁵⁸ See Proposing Release, *supra* note 14, 87 FR at 64622 (discussing existing FICC rules for sponsored member program).

¹⁰⁵⁹ See CCA Standards Adopting Release, *supra* note 10, 81 FR at 70895-97 (discussing Rules 17ad-22(e)(13), (15), and (18)). Although the rule amendment is with respect to Rule 17ad-22(e)(6), the Commission believes that these Rules present the best overall comparison to the rule amendment, in light of the nature of the changes needed to implement the rule amendment here and what was proposed in the Covered Clearing Agency Standards.

¹⁰⁶⁰ This figure was calculated as follows: (Assistant General Counsel for 20 hours) + (Compliance Attorney for 40 hours) + (Computer Operations Manager for 12 hours) + (Senior Programmer for 20 hours) + (Senior Risk Management Specialist for 25 hours) + (Senior Business Analyst for 12 hours) = 129 hours x 2 respondent clearing agencies = 258 hours.

¹⁰⁶¹ See CCA Standards Adopting Release, *supra* note 10, 81 FR at 70893 and 70895-96 (discussing Rules 17ad-22(e)(6) and (13)).

burden of 85 hours per year (including the first year).¹⁰⁶² Therefore, the aggregate ongoing industry burden associated with the amendments to Rule 17ad-22(e)(6) for the two respondents is approximately 170 hours per year.¹⁰⁶³

Name of Information Collection	Type of Burden	Number of Respondents	Initial Burden Per Entity	Aggregate Initial Burden	Ongoing Burden Per Entity	Aggregate Ongoing Burden
17ad-22(e)(6) (Treasury Clearing)	Recordkeeping	2	129 hours	258 hours	85 hours ^a	170 hours ^b

^a See *supra* note 963.

^b See *id.*

B. Amendment to Rule 17ad-22(e)(18)(iv)

The purpose of the collection of information under Rule 17ad-22(e)(18)(iv) is to enable a U.S. Treasury securities CCA to ensure that its direct participants submit for clearance and settlement, as a requirement of membership in the CCA, all eligible secondary market transactions in U.S. Treasury securities to the U.S. Treasury securities CCA to which the direct participants are a counterparty. This should, in turn, help ensure that the risk presented by the eligible secondary market transactions of that direct participant that are not centrally cleared would not be transmitted to the U.S. Treasury securities CCA, and to enable the CCA to identify and manage the risks posed by those transactions that are currently not submitted for central clearing. In addition, the purpose of this rule is to ensure that the U.S. Treasury securities CCA adopts policies and procedures to identify and monitor its direct participants' submission of transactions for clearance and settlement, including how the CCA would address a failure to submit transactions that are required

¹⁰⁶² This figure was calculated as follows: (Compliance Attorney for 25 hours + Business Risk Analyst for 40 hours + Senior Risk Management Specialist for 20 hours) = 85 hours x 2 respondent clearing agencies = 170 ongoing burden hours. (This figure is a corrected version from that in the 2022 Proposing Release, which contained a calculation error in the chart that overstated the estimated burden by 6 hours per respondent, and another calculation error in the accompanying footnote that understated the estimated burden by 5 hours per respondent. See Proposing Release, *supra* note 14, 87 FR at 64675, footnote 505 and accompanying text.)

¹⁰⁶³ This figure was calculated as follows: 85 hours x 2 respondent clearing agencies = 170 hours.

to be submitted. Finally, the purpose of the rule is to ensure that the CCA 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, which policies and procedures the board of directors of such covered clearing agency reviews annually.

This additional collection is mandatory. To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential subject to the provisions of applicable law.¹⁰⁶⁴

The amendment to Rule 17ad-22(e)(18)(iv) requires a U.S. Treasury securities CCA to establish, implement, maintain and enforce written policies and procedures, as discussed above. Because such policies and procedures are not currently required under existing Rule 17ad-22, the Commission believes that the estimated PRA burdens for the amendment to Rule 17ad-22(e)(18)(iv) would be significant and may require a respondent clearing agency to make substantial changes to its policies and procedures. The amendment contains similar provisions to existing rules, but also imposes additional requirements that did not previously appear in Rule 17ad-22.¹⁰⁶⁵ As a result, the Commission believes that a respondent U.S. Treasury securities CCA would incur burdens of reviewing and updating existing policies and procedures in order to comply with the provisions of amended Rule 17ad-22(e)(18)(iv) and, in some cases, may need to create new policies and procedures. Based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for several rules in

¹⁰⁶⁴ See, e.g., 5 U.S.C. 552 *et seq.* Exemption 4 of the Freedom of Information Act provides an exemption for trade secrets and commercial or financial information obtained from a person and privileged or confidential. See 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. See 5 U.S.C. 552(b)(8).

¹⁰⁶⁵ See Proposing Release, *supra* note 14, 87 FR n.34 and accompanying text (discussing current FICC rules).

the Covered Clearing Agency Standards where the Commission anticipated similar burdens,¹⁰⁶⁶ the Commission estimates that the amendment to Rule 17ad-22(e)(18)(iv) would impose on each respondent Treasury securities CCA an initial burden of 260 hours in the first year.¹⁰⁶⁷

In addition, the amendment to Rule 17ad-22(e)(18)(iv) imposes ongoing burdens on a respondent Treasury securities CCA. The amended rule requires ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the amendment. Based on the similar reporting requirements and the corresponding burden estimates previously made by the Commission for several rules in the Covered Clearing Agency Standards where the Commission anticipated similar burdens,¹⁰⁶⁸ the Commission estimates that the ongoing activities required by the amendment to Rule 17ad-22(e)(18)(iv) would impose an ongoing burden of 85 hours per year (including the first year).¹⁰⁶⁹ Therefore, the aggregate ongoing industry burden associated with the amendment to Rule 17ad-22(e)(18)(iv) for the two respondents is approximately 170 hours per year.¹⁰⁷⁰

¹⁰⁶⁶ See CCA Standards Adopting Release, *supra* note 10, 81 FR at 70895-97 (discussing Rules 17ad-22(e)(13), (15), and (18)). The Commission believes that these Rules present the best comparison to the rule amendment, in light of the nature of the rule amendment. Although the rule amendment is with respect to Rule 17ad-22(e)(18), the Commission believes that considering additional rules in the Covered Clearing Agency Standards is reasonable in light of the nature of the rule amendment and the changes necessary to establish and implement the requirements of the rule amendment, as compared to the current Commission rules and U.S. Treasury securities CCA rules.

¹⁰⁶⁷ This figure was calculated as follows: Assistant General Counsel for 40 hours + Compliance Attorney for 80 hours + Computer Operations Manager for 20 hours + Senior Risk Management Specialist for 40 hours + Business Risk Analyst for 80 hours = 260 hours x 2 respondent clearing agencies = 520 hours.

¹⁰⁶⁸ See *supra* note 1066 above (discussing relevant aspects of the Covered Clearing Agency Standards).

¹⁰⁶⁹ This figure was calculated as follows: (Compliance Attorney for 25 hours + Business Risk Analyst for 40 hours + Senior Risk Management Specialist for 20 hours) = 85 ongoing burden hours per year.

¹⁰⁷⁰ This figure was calculated as follows: 85 hours x 2 respondent clearing agencies = 170 hours.

Name of Information Collection	Type of Burden	Number of Respondents	Initial Burden Per Entity	Aggregate Initial Burden	Ongoing Burden Per Entity	Aggregated Ongoing Burden
17ad-22(e)(18) (Treasury Clearing)	Recordkeeping	2	260 hours	520 hours	85 hours ^a	170 hours

^a This figure is a corrected version from that in the 2022 Proposing Release, which contained an error in the calculation that understated the estimated burden by 5 hours. *See* Proposing Release, *supra* note 14, 87 FR at 64675.

B. Broker-Dealers

The final rule amendment to Rule 15c3-3a does not require a new collection of information on the part of any entities subject to these rules. Accordingly, the requirements imposed by the PRA are not applicable to this rule.

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”) requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.¹⁰⁷¹ Section 603(a) of the Administrative Procedure Act,¹⁰⁷² as amended by the RFA, generally requires the Commission to undertake a final regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on “small entities.”¹⁰⁷³ Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule which, if adopted, would not have a significant economic impact on a substantial number of small entities.¹⁰⁷⁴ In the Proposing Release, the Commission certified that the proposed amendments to Rules 17ad-22 and 15c3-3a would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Proposing Release solicited comment on the certification. The Commission received no comments on this certification.

¹⁰⁷¹ *See* 5 U.S.C. 601 *et seq.*

¹⁰⁷² 5 U.S.C. 603(a).

¹⁰⁷³ Section 601(b) of the RFA permits agencies to formulate their own definitions of “small entities.” *See* 5 U.S.C. 601(b). The Commission has adopted definitions for the term “small entity” for the purposes of rulemaking in accordance with the RFA. These definitions, as relevant to this rulemaking, are set forth in 17 CFR 240.0-10.

¹⁰⁷⁴ *See* 5 U.S.C. 605(b).

A. Clearing Agencies

The amendments to Rule 17ad-22 would apply to covered clearing agencies, which would include registered clearing agencies that provide the services of a central counterparty or central securities depository.¹⁰⁷⁵ For the purposes of Commission rulemaking and as applicable to the proposed amendments to Rule 17ad-22, a small entity includes, when used with reference to a clearing agency, a clearing agency that (i) compared, cleared, and settled less than \$500 million in securities transactions during the preceding fiscal year, (ii) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter), and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.¹⁰⁷⁶

Based on the Commission's existing information about the clearing agencies currently registered with the Commission, the Commission believes that such entities exceed the thresholds defining "small entities" set out above. While other clearing agencies may emerge and seek to register as clearing agencies, the Commission does not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.¹⁰⁷⁷ In any case, clearing agencies can only become subject to the new requirements under Rule 17ad-22(e) should they meet the definition of a covered clearing agency, as described above. Accordingly, the Commission believes that any such registered clearing agencies will exceed the thresholds for "small entities" set forth in Exchange Act Rule 0-10.

¹⁰⁷⁵ 17 CFR 240.17ad-22(a)(5).

¹⁰⁷⁶ See 17 CFR 240.0-10(d).

¹⁰⁷⁷ See 17 CFR 240.0-10(d). The Commission based this determination on its review of public sources of financial information about registered clearing agencies and lifecycle event service providers for OTC derivatives.

B. Broker-Dealers

For purposes of Commission rulemaking in connection with the RFA, a small entity includes a broker-dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act, or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.¹⁰⁷⁸ Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (1) for entities in credit intermediation and related activities, firms with \$175 million or less in assets; (2) for non-depository credit intermediation and certain other activities, firms with \$7 million or less in annual receipts; (3) for entities in financial investments and related activities, firms with \$7 million or less in annual receipts; (4) for insurance carriers and entities in related activities, firms with \$7 million or less in annual receipts; and (5) for funds, trusts, and other financial vehicles, firms with \$7 million or less in annual receipts.

The final rule amendment to Rule 15c3-3a would permit margin required and on deposit with covered clearing agencies for U.S. Treasury securities to be included by broker-dealers as a debit in the reserve formulas for accounts of customers and proprietary accounts of broker-dealers, subject to certain conditions. Only carrying broker-dealers will be impacted by the final rule amendment. This is because only carrying broker-dealers are required to maintain a customer or PAB reserve account and may collect customer margin.

¹⁰⁷⁸ See 17 CFR 240.0-10(c).

Based on FOCUS Report data, the Commission estimates that as of June 30, 2023, there were approximately 772 broker-dealers that were “small” for the purposes of Rule 0-10. Of these, the Commission estimates that there are less than ten broker-dealers that are carrying broker-dealers (*i.e.*, can carry customer or PAB margin accounts and extend credit). However, based on June 30, 2023, FOCUS Report data, none of these small carrying broker-dealers carried debit balances. This means that any “small” carrying firms are not extending margin credit to their customers, and therefore, the final rule amendment likely would not apply to them. Therefore, while the Commission believes that some small broker-dealers could be affected by the final amendment, the amendment will not have a significant impact on a substantial number of small broker-dealers.

C. Certification

For the reasons described above, the Commission certifies that the final amendments to Rules 17ad-22 and 15c3-3a would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VII. Other Matters

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act,¹⁰⁷⁹ the Office of Information and Regulatory Affairs has designated these rules as a “major rule,” as defined by 5 U.S.C. 804(2).

¹⁰⁷⁹ 5 U.S.C. 801 *et seq.*

Statutory Authority

The Commission is amending Rule 17ad-22 under the Commission's rulemaking authority set forth in section 17A of the Exchange Act, 15 U.S.C. 78q-1, and section 805 of the Clearing Supervision Act, 15 U.S.C. 5464 respectively. Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.*, and particularly, sections 15 and 23(a) (15 U.S.C. 78o and 78w(a)), thereof, the Commission is amending § 240.15c3-3a under the Exchange Act.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

Text of Amendments

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The general authority citation for part 240 continues to read, and the sectional authority for § 240.17ad-22 is revised to read, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

Section 240.15c3-3a is also issued under Pub. L. 111-203, §§ 939, 939A, 124 Stat. 1376 (2010) (15 U.S.C. 78c, 15 U.S.C. 78o-7 note).

* * * * *

Section 240.17ad-22 is also issued under 12 U.S.C. 5461 *et seq.*

* * * * *

2. Revise and republish § 240.15c3-3a to read as follows:

§ 240.15c3-3a Exhibit A—Formula for determination of customer and PAB account reserve requirements of brokers and dealers under § 240.15c3-3.

	Credits	Debits
1. Free credit balances and other credit balances in customers' security accounts. (See Note A).....	XXX	.....
2. Monies borrowed collateralized by securities carried for the accounts of customers (See Note B).....	XXX	.....
3. Monies payable against customers' securities loaned (See Note C).....	XXX	.....
4. Customers' securities failed to receive (See Note D).....	XXX	.....
5. Credit balances in firm accounts which are attributable to principal sales to customers.	XXX	.....
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days.....	XXX	.....
7. Market value of short security count differences over 30 calendar days old.....	XXX	.....
8. Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days.	XXX	.....
9. Market value of securities which are in transfer in excess of 40 calendar days and have not		

been confirmed to be in transfer by the transfer agent or the issuer during the 40 days.....	XXX	.....
10. Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection. (See Note E).....	.....	XXX
11. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver.....	.....	XXX
12. Failed to deliver of customers' securities not older than 30 calendar days.....	.....	XXX
13. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts. (See Note F).....	.....	XXX
14. Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in customer accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (See Note G) .....	.....	XXX
15. Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q-1) resulting from the following types of transactions in U.S. Treasury securities in customer accounts that have been cleared, settled, and novated by the clearing agency: (1) purchases and sales of U.S. Treasury securities; and (2) U.S. Treasury securities		

repurchase and reverse repurchase agreements (See Note H) .....	.....	XXX
Total credits..... Total debits.....	..... .....	..... .....
16. Excess of total credits (sum of items 1-9) over total debits (sum of items 10-15) required to be on deposit in the “Reserve Bank Account” (§ 240.15c3-3(e)). If the computation is made monthly as permitted by this section, the deposit must be not less than 105 percent of the excess of total credits over total debits.	.....	XXX

Notes Regarding the Customer Reserve Bank Account Computation

Note A. Item 1 must include all outstanding drafts payable to customers which have been applied against free credit balances or other credit balances and must also include checks drawn in excess of bank balances per the records of the broker or dealer.

Note B. Item 2 must include the amount of options-related or security futures product-related Letters of Credit obtained by a member of a registered clearing agency or a derivatives clearing organization which are collateralized by customers’ securities, to the extent of the member’s margin requirement at the registered clearing agency or derivatives clearing organization. Item 2 must also include the amount of Letters of Credit which are collateralized by customers’ securities and related to other futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule. Item 2 must include the market value of customers’ securities on deposit at a “qualified clearing agency” as defined in Note H below.

Note C. Item 3 must include in addition to monies payable against customers' securities loaned the amount by which the market value of securities loaned exceeds the collateral value received from the lending of such securities.

Note D. Item 4 must include in addition to customers' securities failed to receive the amount by which the market value of securities failed to receive and outstanding more than thirty (30) calendar days exceeds their contract value.

Note E. (1) Debit balances in margin accounts must be reduced by the amount by which a specific security (other than an exempted security) which is collateral for margin accounts exceeds in aggregate value 15 percent of the aggregate value of all securities which collateralize all margin accounts receivable; provided, however, the required reduction must not be in excess of the amounts of the debit balance required to be excluded because of this concentration rule. A specified security is deemed to be collateral for a margin account only to the extent it represents in value not more than 140 percent of the customer debit balance in a margin account.

(2) Debit balances in special omnibus accounts, maintained in compliance with the requirements of Section 7(f) of Regulation T (12 CFR 220.7(f)) or similar accounts carried on behalf of another broker or dealer, must be reduced by any deficits in such accounts (or if a credit, such credit must be increased) less any calls for margin, mark to the market, or other required deposits which are outstanding five business days or less.

(3) Debit balances in customers' cash and margin accounts included in the formula under Item 10 must be reduced by an amount equal to 1 percent of their aggregate value.

(4) Debit balances in cash and margin accounts of household members and other persons related to principals of a broker or dealer and debit balances in cash and margin accounts of affiliated persons of a broker or dealer must be excluded from the Reserve Formula, unless the

broker or dealer can demonstrate that such debit balances are directly related to credit items in the formula.

(5) Debit balances in margin accounts (other than omnibus accounts) must be reduced by the amount by which any single customer's debit balance exceeds 25 percent (to the extent such amount is greater than \$50,000) of the broker-dealer's tentative net capital (*i.e.*, net capital prior to securities haircuts) unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the Reserve Formula. Related accounts (*e.g.*, the separate accounts of an individual, accounts under common control or subject to cross guarantees) will be deemed to be a single customer's accounts for purposes of this provision. If the registered national securities exchange or the registered national securities association having responsibility for examining the broker or dealer ("designated examining authority") is satisfied, after taking into account the circumstances of the concentrated account including the quality, diversity, and marketability of the collateral securing the debit balances or margin accounts subject to this provision, that the concentration of debit balances is appropriate, then such designated examining authority may grant a partial or plenary exception from this provision. The debit balance may be included in the reserve formula computation for five business days from the day the request is made.

(6) Debit balances in joint accounts, custodian accounts, participation in hedge funds or limited partnerships or similar type accounts or arrangements that include both assets of a person or persons who would be excluded from the definition of customer ("noncustomer") and assets of a person or persons who would be included in the definition of customer must be included in the Reserve Formula in the following manner: if the percentage ownership of the non-customer is less than 5 percent then the entire debit balance shall be included in the formula; if such percentage ownership is between 5 percent and 50 percent then the portion of the debit balance attributable to

the non-customer must be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula; or if such percentage ownership is greater than 50 percent, then the entire debit balance must be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula.

Note F. Item 13 must include the amount of margin required and on deposit with the Options Clearing Corporation to the extent such margin is represented by cash, proprietary qualified securities and letters of credit collateralized by customers' securities.

Note G. (a) Item 14 must include the amount of margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) for customer accounts to the extent that the margin is represented by cash, proprietary qualified securities, and letters of credit collateralized by customers' securities.

(b) Item 14 will apply only if the broker or dealer has the margin related to security futures products, or futures (and options thereon) carried in a securities account pursuant to an approved SRO portfolio margining program on deposit with:

(1) A registered clearing agency or derivatives clearing organization that:

(i) Maintains security deposits from clearing members in connection with regulated options or futures transactions and assessment power over member firms that equal a combined total of at least \$2 billion, at least \$500 million of which must be in the form of security deposits. For the purposes of this Note G, the term "security deposits" refers to a general fund, other than margin

deposits or their equivalent, that consists of cash or securities held by a registered clearing agency or derivative clearing organization; or

(ii) Maintains at least \$3 billion in margin deposits; or

(iii) Does not meet the requirements of paragraphs (b)(1)(i) through (b)(1)(iii) of this Note G, if the Commission has determined, upon a written request for exemption by or for the benefit of the broker or dealer, that the broker or dealer may utilize such a registered clearing agency or derivatives clearing organization. The Commission may, in its sole discretion, grant such an exemption subject to such conditions as are appropriate under the circumstances, if the Commission determines that such conditional or unconditional exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors; and

(2) A registered clearing agency or derivatives clearing organization that, if it holds funds or securities deposited as margin for security futures products or futures in a portfolio margin account in a bank, as defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)), obtains and preserves written notification from the bank at which it holds such funds and securities or at which such funds and securities are held on its behalf. The written notification will state that all funds and/or securities deposited with the bank as margin (including customer security futures products and futures in a portfolio margin account), or held by the bank and pledged to such registered clearing agency or derivatives clearing agency as margin, are being held by the bank for the exclusive benefit of clearing members of the registered clearing agency or derivatives clearing organization (subject to the interest of such registered clearing agency or derivatives clearing organization therein), and are being kept separate from any other accounts maintained by the registered clearing agency or derivatives clearing organization with the bank. The written notification also will provide that such funds and/or securities will at no time be used directly or

indirectly as security for a loan to the registered clearing agency or derivatives clearing organization by the bank, and will be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank. This provision, however, will not prohibit a registered clearing agency or derivatives clearing organization from pledging customer funds or securities as collateral to a bank for any purpose that the rules of the Commission or the registered clearing agency or derivatives clearing organization otherwise permit; and

(3) A registered clearing agency or derivatives clearing organization establishes, documents, and maintains:

(i) Safeguards in the handling, transfer, and delivery of cash and securities;

(ii) Fidelity bond coverage for its employees and agents who handle customer funds or securities. In the case of agents of a registered clearing agency or derivatives clearing organization, the agent may provide the fidelity bond coverage; and

(iii) Provisions for periodic examination by independent public accountants; and

(iv) A derivatives clearing organization that, if it is not otherwise registered with the Commission, has provided the Commission with a written undertaking, in a form acceptable to the Commission, executed by a duly authorized person at the derivatives clearing organization, to the effect that, with respect to the clearance and settlement of the customer security futures products and futures in a portfolio margin account of the broker or dealer, the derivatives clearing organization will permit the Commission to examine the books and records of the derivatives clearing organization for compliance with the requirements set forth in § 240.15c3-3a, Note G

(b)(1) through (3).

(c) Item 14 will apply only if a broker or dealer determines, at least annually, that the registered clearing agency or derivatives clearing organization with which the broker or dealer has on deposit margin related to securities future products or futures in a portfolio margin account meets the conditions of this Note G.

Note H. (a) Item 15 must include the amount of margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q-1) that clears, settles, and novates transactions in U.S. Treasury securities (“qualified clearing agency”) to the extent that the margin is:

- (1) In the form of cash, U.S. Treasury securities, or qualified customer securities; and
- (2) Being used to margin U.S. Treasury securities positions of the customers of the broker or dealer that are cleared, settled, and novated by the qualified clearing agency.

(b) Item 15 will apply only if the cash and securities required and on deposit at the qualified clearing agency:

(1)(i) Are cash owed by the broker or dealer to the customer of the broker or dealer that was delivered by the broker or dealer to the qualified clearing agency to meet a margin requirement resulting from that customer’s U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency and not for any other customer’s or the broker’s or dealer’s U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency;

(ii) U.S. Treasury securities or qualified customer securities held in custody by the broker or dealer for the customer of the broker or dealer that were delivered by the broker or dealer to the qualified clearing agency to meet a margin requirement resulting from that customer’s U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency and not

for any other customer's or the broker's or dealer's U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency; or

(iii) U.S. Treasury securities owned by the broker or dealer that were delivered by the broker or dealer to the qualified clearing agency to meet a margin requirement resulting from a customer's U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency under the following conditions:

(A) The broker or dealer did not owe to the customer or hold in custody for the customer sufficient cash, U.S. Treasury securities, and/or qualified customer securities to meet a margin requirement resulting from that customer's U.S. Treasury securities positions cleared, settled, and novated at the qualified clearing agency at the time the margin requirement arose;

(B) The broker or dealer calls for the customer to deliver a sufficient amount of cash, U.S. Treasury securities, and/or qualified customer securities to meet the margin requirement on the day the margin requirement arose; and

(C) The broker or dealer receives a sufficient amount of cash, U.S. Treasury securities, and/or qualified customer securities to meet the margin requirement by the close of the next business day after the margin requirement arose.

(2) Are treated in accordance with rules of the qualified clearing agency that impose the following requirements and the qualified clearing agency and broker or dealer are in compliance with the requirements of the rules (as applicable);

(i) Rules requiring the qualified clearing agency to calculate a separate margin amount for each customer of the broker or dealer and the broker or dealer to deliver that amount of margin for each customer on a gross basis;

(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;

(iii) Rules requiring that the cash, U.S. Treasury securities, and qualified customer 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, U.S. Treasury securities, and qualified customer 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, U.S. Treasury securities, and qualified customer 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;

(iv) Rules requiring the qualified clearing agency to hold the customer cash, U.S. Treasury securities, and qualified customer securities used to margin the U.S. Treasury securities positions of the customers of the broker or dealer itself or in an account of the clearing agency at a U.S. Federal Reserve Bank or a “bank,” as that term is defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)), that is insured by the Federal Deposit Insurance Corporation, and that the account at the U.S. Federal Reserve Bank or bank must be:

(A) Segregated from any other account of the qualified clearing agency or any other person at the U.S. Federal Reserve Bank or bank and used exclusively to hold cash, U.S. Treasury securities, and qualified customer securities to meet current margin requirements of the qualified clearing agency resulting from positions in U.S. Treasury securities of the customers of the broker or dealer members of the qualified clearing agency;

(B) Subject to a written notice of the U.S. Federal Reserve Bank or bank provided to and retained by the qualified clearing agency that the cash, U.S. Treasury securities, and qualified customer securities in the account are being held by the U.S. Federal Reserve Bank or bank pursuant to § 240.15c3-3 and are being kept separate from any other accounts maintained by the qualified clearing agency or any other person at the U.S. Federal Reserve Bank or bank; and

(C) Subject to a written contract between the qualified clearing agency and the U.S. Federal Reserve Bank or bank which provides that the cash, U.S. Treasury securities, and qualified customer securities in the account are subject to no right, charge, security interest, lien, or claim of

any kind in favor of the U.S. Federal Reserve Bank or bank or any person claiming through the U.S. Federal Reserve Bank or bank; and

(v) Rules requiring systems, controls, policies, and procedures to return cash, U.S. Treasury securities, and qualified customer securities to the broker or dealer that are no longer needed to meet a current margin requirement resulting from positions in U.S. Treasury securities of the customers of the broker or dealer; and

(3) The Commission has approved rules of the qualified clearing agency that meet the conditions of this Note H and has published (and not subsequently withdrawn) a notice that brokers or dealers may include a debit in the customer reserve formula when depositing cash, U.S. Treasury securities, and/or qualified customer securities to meet a margin requirement of the qualified clearing agency resulting from positions in U.S. Treasury securities of the customers of the broker or dealer.

(c) As used in this Note H, the term “qualified customer securities” means the securities of a customer of the broker or dealer (other than U.S. Treasury securities) that are held in custody by the broker or dealer for the customer and that under the rules of the qualified clearing agency are eligible to be used to margin U.S. Treasury securities positions of the customer that are cleared, settled, and novated by the qualified clearing agency.

Notes Regarding the PAB Reserve Bank Account Computation

Note 1. Broker-dealers should use the formula in Exhibit A for the purposes of computing the PAB reserve requirement, except that references to “accounts,” “customer accounts, or “customers” will be treated as references to PAB accounts.

Note 2. Any credit (including a credit applied to reduce a debit) that is included in the computation required by § 240.15c3-3 with respect to customer accounts (the “customer reserve

computation”) may not be included as a credit in the computation required by § 240.15c3-3 with respect to PAB accounts (the “PAB reserve computation”).

Note 3. Note E(1) to § 240.15c3-3a does not apply to the PAB reserve computation.

Note 4. Note E(3) to § 240.15c3-3a which reduces debit balances by 1 percent does not apply to the PAB reserve computation.

Note 5. Interest receivable, floor brokerage, and commissions receivable of another broker or dealer from the broker or dealer (excluding clearing deposits) that are otherwise allowable assets under § 240.15c3-1 need not be included in the PAB reserve computation, provided the amounts have been clearly identified as payables on the books of the broker or dealer.

Commissions receivable and other receivables of another broker or dealer from the broker or dealer that are otherwise non-allowable assets under § 240.15c3-1 and clearing deposits of another broker or dealer may be included as “credit balances” for purposes of the PAB reserve computation, provided the commissions receivable and other receivables are subject to immediate cash payment to the other broker or dealer and the clearing deposit is subject to payment within 30 days.

Note 6. Credits included in the PAB reserve computation that result from the use of securities held for a PAB account (“PAB securities”) that are pledged to meet intra-day margin calls in a cross-margin account established between the Options Clearing Corporation and any regulated derivatives clearing organization may be reduced to the extent that the excess margin held by the other clearing corporation in the cross-margin relationship is used the following business day to replace the PAB securities that were previously pledged. In addition, balances resulting from a portfolio margin account that are segregated pursuant to Commodity Futures

Trading Commission regulations need not be included in the PAB Reserve Bank Account computation.

Note 7. Deposits received prior to a transaction pending settlement which are \$5 million or greater for any single transaction or \$10 million in aggregate may be excluded as credits from the PAB reserve computation if such balances are placed and maintained in a separate PAB Reserve Bank Account by 12 p.m. Eastern Time on the following business day. Thereafter, the money representing any such deposits may be withdrawn to complete the related transactions without performing a new PAB reserve computation.

Note 8. A credit balance resulting from a PAB reserve computation may be reduced by the amount that items representing such credits are swept into money market funds or mutual funds of an investment company registered under the Investment Company Act of 1940 on or prior to 10 a.m. Eastern Time on the deposit date provided that the credits swept into any such fund are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the investment company or the broker or dealer. Any credits that have been swept into money market funds or mutual funds must be maintained in the name of a particular broker or for the benefit of another broker.

Note 9. Clearing deposits required to be maintained at registered clearing agencies may be included as debits in the PAB reserve computation to the extent the percentage of the deposit, which is based upon the clearing agency's aggregate deposit requirements (*e.g.*, dollar trading volume), that relates to the proprietary business of other brokers and dealers can be identified. However, Note H to Item 15 of § 240.15c3-3a applies with respect to margin delivered to a U.S. Treasury securities clearing agency.

Note 10. A broker or dealer that clears PAB accounts through an affiliate or third party clearing broker must include these PAB account balances and the omnibus PAB account balance in its PAB reserve computation.

3. Redesignate § 240.17Ad-22 as § 240.17ad-22 and amend newly redesignated § 240.17ad-22 by:

a. In paragraph (a):

i. Removing the second-level paragraph designations, and

ii. Inserting in alphabetical order definitions for “Affiliated counterparty”, “Central bank”, “Eligible secondary market transaction”, “International financial institution”, “State or local government”, “Sovereign entity”, and “U.S. Treasury security”.

b. Revising paragraphs (e)(6)(i) and (18).

The revisions and additions read as follows:

§ 240.17ad-22 Standards for clearing agencies.

(a) * * *

Affiliated counterparty means any counterparty which meets the following criteria:

(i) The counterparty is either a bank (as defined in 15 U.S.C. 78c(6)), broker (as defined in 15 U.S.C. 78c(4)), dealer (as defined in 15 U.S.C. 78c(5)), or futures commission merchant (as defined in 7 U.S.C. 1a(28)), or any entity regulated as a bank, broker, dealer, or futures commission merchant in its home jurisdiction;

(ii) The counterparty holds, directly or indirectly, a majority ownership interest in the direct participant, or the direct participant, directly or indirectly, holds a majority ownership interest in the counterparty, or a third party, directly or indirectly, holds a majority ownership interest in both the direct participant and the counterparty; and

(iii) The counterparty, direct participant, or third party referenced in paragraph (ii) of this definition as holding the majority ownership interest would be required to report its financial statements on a consolidated basis under U.S. Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of the majority-owned party or of both majority-owned parties.

* * * * *

Central bank means a reserve bank or monetary authority of a central government (including the Board of Governors of the Federal Reserve System or any of the Federal Reserve Banks) and the Bank for International Settlements.

* * * * *

Eligible secondary market transaction refers to a secondary market transaction in U.S. Treasury securities of a type accepted for clearing by a registered covered clearing agency that is:

(i) A repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities, in which one of the counterparties is a direct participant; or

(ii) A purchase or sale, between a direct participant and:

(A) Any counterparty, if the direct participant of the covered clearing agency brings together multiple buyers and sellers using a trading facility (such as a limit order book) and is a counterparty to both the buyer and seller in two separate transactions; or

(B) Registered broker-dealer, government securities broker, or government securities dealer; except that:

(iii) Any purchase or sale transaction in U.S. Treasury securities or repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a

central bank, a sovereign entity, an international financial institution, or a natural person shall be excluded from the definition set forth in this section of an eligible secondary market transaction;

(iv) Any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a covered clearing agency providing central counterparty services or a derivatives clearing organization (*see* 7 U.S.C. 7a-1 and 17 CFR 39.3), or is regulated as a central counterparty in its home jurisdiction, shall be excluded from the definition set forth in this section of an eligible secondary market transaction;

(v) Any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities in which one counterparty is a state or local government shall be excluded from the definition set forth in this section of an eligible secondary market transaction;

(vi) Any repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities entered into between a direct participant and an affiliated counterparty shall be excluded from the definition set forth in this section of an eligible secondary market transaction, provided that the affiliated counterparty submit for clearance and settlement all other repurchase or reverse repurchase agreements collateralized by U.S. Treasury securities to which the affiliate is a party.

* * * * *

International financial institution means the African Development Bank; African Development Fund; Asian Development Bank; Banco Centroamericano de Integración Económica; Bank for Economic Cooperation and Development in the Middle East and North Africa; Caribbean Development Bank; Corporación Andina de Fomento; Council of Europe Development Bank; European Bank for Reconstruction and Development; European Investment Bank; European Investment Fund; European Stability Mechanism; Inter-American Development Bank; Inter-American Investment Corporation; International Bank for Reconstruction and

Development; International Development Association; International Finance Corporation; International Monetary Fund; Islamic Development Bank; Multilateral Investment Guarantee Agency; Nordic Investment Bank; North American Development Bank; and any other entity that provides financing for national or regional development in which the U.S. Government is a shareholder or contributing member.

* * * * *

Sovereign entity means a central government (including the U.S. Government), or an agency, department, or ministry of a central government.

* * * * *

State or local government means a state or any political subdivision thereof, or an agency or instrumentality of a State or any political subdivision thereof, but shall not include any pension or retirement plan established and maintained by a State, its political subdivisions, or any agency or instrumentality of a State or its political subdivisions, for the benefit of its employees.

* * * * *

U.S. Treasury security means any security issued by the U.S. Department of the Treasury.

* * * * *

(e) * * *

(6) * * *

(i) Considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, and, if the covered clearing agency provides central counterparty services for U.S. Treasury securities, calculates, collects, and holds margin amounts from a direct participant for its proprietary positions in Treasury securities separately and independently from margin calculated and collected from that direct participant in

connection with U.S. Treasury securities transactions by an indirect participant that relies on the services provided by the direct participant to access the covered clearing agency's payment, clearing, or settlement facilities;

* * * * *

(18) Establish objective, risk-based, and publicly disclosed criteria for participation, which

(i) Permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities;

(ii) Require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency;

(iii) Monitor compliance with such participation requirements on an ongoing basis; and

(iv) When the covered clearing agency provides central counterparty services for transactions in U.S. Treasury securities,

(A) Require that any direct participant of such covered clearing agency submit for clearance and settlement all of the eligible secondary market transactions to which such direct participant is a counterparty;

(B) Identify and monitor its direct participants' submission of transactions for clearing as required in paragraph (e)(18)(iv)(A) of this section, including how the covered clearing agency would address a failure to submit transactions in accordance with paragraph (e)(18)(iv)(A) of this section; and

(C) 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, which policies and procedures the board of directors of such covered clearing agency reviews annually.

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By the Commission.

Dated: December 13, 2023.

J. Matthew DeLesDernier,

Deputy Secretary.