SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 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: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') proposes 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 proposes 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 proposes to amend 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: Comments should be received on or before December 27, 2022.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*https://www.sec.gov/rules/submitcomments.htm*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number S7–23–22 on the subject line.

Paper Comments

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–23–22. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's Public Reference Room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Elizabeth L. Fitzgerald, Assistant Director, Office of Clearance and Settlement at (202) 551–5710, Division of Trading and Markets; Michael A. Macchiaroli, Associate Director, at (202) 551–5525; Thomas K. McGowan, Associate Director, at (202) 551–5521; Randall W. Roy, Deputy Associate Director, at (202) 551–5522; Raymond Lombardo, Assistant Director, at 202–551–5755; Sheila Dombal Swartz, Senior Special Counsel, at (202) 551–5545; or Nina Kostyukovsky, Special Counsel, at (202) 551–8833, Office of Broker-Dealer Finances, Division of Trading and Markets; U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–7010.

SUPPLEMENTARY INFORMATION: First, the Commission proposes to amend 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 CCA must review annually. The Commission would define eligible secondary market transactions 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. Second, the Commission proposes to amend 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. In connection with these proposed amendments, the Commission is also proposing to include 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,'' and ''sovereign entity.'' Third, the Commission proposes to amend 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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I. Introduction

A. The Commission's Role in Facilitating the National System of Clearance and Settlement for Securities, Including Treasury Securities

In 1975, Congress added section 17A to the Securities Exchange Act of 1934 (''Exchange Act'') as part of the Securities Acts Amendments of 1975, which 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 which typically includes U.S. Treasury securities, except as discussed further below), and (ii) linked or coordinated facilities for clearance and settlement of securities transactions.[1] In so doing, Congress made several findings related to the importance of the clearance and settlement of securities transactions and the relationship of clearance and settlement of securities transactions to the protection of investors.[2] The Commission carries out its statutory mandate in this regard through its supervision and regulation of registered clearing agencies, which may provide

[1] *See* 15 U.S.C. 78q–1; Report of the Senate Committee on Banking, Housing & Urban Affairs, S. Rep. No. 94–75, at 4 (1975) (stating the Committee's belief that ''the banking and security industries must move quickly toward the establishment of a fully integrated national system for the prompt and accurate processing and settlement of securities transactions'').

[2] *See* 15 U.S.C. 78q–1(a)(1)(A) (finding that ''[t]he prompt and accurate clearance and settlement of securities transactions . . . are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors''); *see also* 15 U.S.C. 78q–1(B), (C), and (D) (setting forth additional findings related to the national system of clearance and settlement).

different services to the market including, but not limited to, central counterparty services.

In 1986, Congress passed the Government Securities Act, which, among other things, authorized the Commission to regulate clearing agencies engaged in the clearance and settlement of government securities transactions, including those in U.S. Treasury securities, by providing that government securities would not be considered exempt securities for purposes of section 17A of the Exchange Act.[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]

B. The Role of Central Counterparty Services

The Commission defines a CCP as a clearing agency that interposes itself between the counterparties to securities transactions, acting functionally as the buyer to every seller and the seller to every buyer.[6] The Commission previously has stated that registered clearing agencies that provide CCP services can help increase the safety and efficiency of securities trading, while reducing costs.[7] These benefits could be particularly significant in times of market stress, as CCPs would mitigate the potential for a single market participant's failure to destabilize other market participants or the financial system more broadly, and/or reduce the effects of misinformation and rumors.[8] A CCP also addresses concerns about counterparty risk by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity of the counterparties.[9] 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.'' [10] However, the Commission has also recognized that this centralization of activity at clearing agencies makes risk management at such entities a critical function, as reflected in the adoption of additional enhanced Commission requirements, discussed further in section II.B.1 *infra.*[11]

Since the enactment of the Securities Acts Amendments of 1975, the Commission has had extensive experience with the risks associated with bilateral clearing and the benefits of centralized clearance and settlement systems for securities. Based on its experience supervising registered clearing agencies, the Commission believes that, over the years, the clearing agencies registered with the Commission that provide CCP services have reduced costs of securities trading, and have been carefully structured, consistent with the Commission's statutory and regulatory authority, to provide the benefits of clearing, such as multilateral netting [12] and centralized default management, while also managing and reducing counterparty risk. To further the establishment of linked and coordinated facilities for clearance and settlement of securities transactions, the Commission adopted 17 CFR 240.17Ad–22, which sets forth standards for clearing agencies registered with the Commission. These standards address all aspects of a CCP's operations, including financial risk management, operational risk, default management, governance, and participation requirements.

C. Existing CCP Services for the U.S. Treasury Market

Currently, only one registered clearing agency, the Fixed Income Clearing Corporation (''FICC''),[13] provides CCP services for U.S. Treasury securities transactions, including cash transactions and repurchase transactions (''repos''), which are described more fully in section II.A *infra.*[14] As a CCP, FICC novates transactions between two counterparties, effectively becoming the buyer to every seller and the seller to every buyer, and guarantees the settlement of the novated transactions. This means that FICC is exposed to a number of risks arising from such transactions, including counterparty credit risk.[15] Because the vast majority of counterparty credit risk is managed bilaterally in the U.S. Treasury market, as discussed more fully in section III.A.3 *infra,* FICC may face potential contagion risk arising from transactions entered into by one of its participants, even if those transactions are not centrally cleared.[16] Currently, most of

[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 (''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'').

[6] 17 CFR 240.17Ad–22(a)(2).

[7] Covered Clearing Agency Standards Proposing Release, Exchange Act Release No. 71699 (Mar. 12, 2014), 79 FR 29507, 29510 (May 27, 2014) (''CCA Standards Proposing Release'').

[8] *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).

[9] *Id.*

[10] CCA Standards Proposing Release, *supra* note 7, 79 FR at 29587.

[11] *See, e.g., id.* at 29510.

[12] With multilateral netting, the CCP is able to offset obligations involving the same security across multiple counterparties, thereby reducing the overall amount of securities and funds that need to be delivered. *See* notes 251 and 252 and accompanying text *infra* for additional explanation, as well as an example, of multilateral netting.

[13] FICC has two divisions. The Government Securities Division generally provides clearing services for U.S. Treasury securities, and the Mortgage-Backed Securities Division, generally provides clearing services for mortgage-backed securities. For purposes of this release, references to FICC will refer to FICC's Government Securities Division (''GSD''), unless otherwise indicated.

[14] For purposes of this release, an entity providing CCP services in the U.S. Treasury market and therefore serving as a covered clearing agency will be referred to as a ''U.S. Treasury securities CCA.''

[15] Counterparty credit risk refers to the potential for a market participant's counterparty to a given transaction to default on the transaction and therefore the market participant will not receive either the cash or securities necessary to settle the transaction.

[16] *See, e.g.,* U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities Capital Markets,* at 81 (Oct. 2017), *available at https://home.treasury.gov/system/files/*

FICC's direct participants are banks and broker-dealers, while other types of entities, such as registered investment companies, investment advisers, and asset owners, rely on FICC's direct participants to access central clearing indirectly and are not direct participants of FICC.

As the only entity providing CCP services in the U.S. Treasury market, if FICC were unable to provide its CCP services for any reason, it could have a broad and severe impact on the overall U.S. economy, as the Financial Stability Oversight Council (''FSOC'') recognized when it designated FICC as a systemically important financial market utility in 2012.[17] Designation of an entity as a systemically important financial market utility brings heightened risk management requirements and additional regulatory supervision, by both its primary regulator and the Board of Governors of the Federal Reserve System.[18] The Commission relied, in part, on this heightened supervisory authority under Title VIII of the Dodd-Frank Act to adopt the Covered Clearing Agency Standards.

Over the past several years, both the private and public sectors have observed the increased volume of U.S. Treasury secondary market transactions that are not centrally cleared.[19] However, because data for these transactions is subject to different and incomplete reporting requirements, it is difficult to quantify this activity. The best available estimates at this time are those developed by private sector organizations. In particular, the Treasury Market Practice Group [20] 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 described in section II.A.1 *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.[21] In addition, the G–30 Report estimated that ''roughly 20 percent of commitments to settle U.S. Treasury security trades are cleared through FICC.'' [22]

Both the TMPG and the Group of 30 also identified the significant risks associated with bilateral clearing.[23] For example, the TMPG stated that ''[b]ilateral 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. An increase in bilaterally cleared trades likely increases the aggregate liquidity risk in the clearing and settlement process because, unlike a CCP, bilateral arrangements may not have the discipline of establishing a contingent liquidity risk framework or uniform requirements for emergency liquidity.'' [24]

D. Proposal

The Commission believes that a covered clearing agency, including one that provides CCP services,[25] is most effective when its participation standards enable the CCA to understand and control the risks presented by its direct participants because such standards are an important tool to limit the potential for member defaults and, as a result, losses to non-defaulting members in the event of a member default, thereby protecting the securities market as a whole.[26] For example, when proposing the Covered Clearing Agency Standards in Rule 17Ad–22 in 2014, the Commission explained that ''[a]ppropriate minimum operational, legal, and capital requirements for membership that are maintained and enforced through the supervisory practices of a clearing agency help to ensure all members will be reasonably capable of meeting their various obligations to the clearing agency in stressed market conditions and upon member default.'' [27] To that end, the Commission's rules governing the participation requirements of a CCA are designed to achieve that goal. Rule 17Ad–22(e)(18) requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, establish objective, risk-based and publicly disclosed criteria for participation,[28] and 17 CFR 240.17Ad–22(e)(19) (''Rule 17Ad–22(e)(19)'') requires a CCA to maintain written policies and procedures reasonably designed to, as applicable, identify, monitor and manage the material risks to it arising from arrangements in which firms that are indirect participants in the CCA rely on the services provided to it by direct participants to access the CCA's payment, clearing, or settlement facilities.[29]

As described more fully in section III *infra,* the increasing volume of non-centrally cleared transactions in U.S. Treasury securities may render U.S. Treasury securities CCAs more susceptible to member defaults from risks outside the transactions cleared by the CCA, and as a result the

136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf (''2017 Treasury Report'') (discussing issues caused by fragmented central clearing with respect to [interdealer brokers] at FICC and describing this contagion risk and stating ''if a large [proprietary trading firm] with unsettled trading volumes were to fail, the failure could introduce risk to the market and market participants'').

[17] Financial Stability Oversight Council, *2012 Annual Report,* Appendix A, *available at http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf* (''FSOC 2012 Annual Report'').

[18] *Id.* at 119. The Commission previously has acknowledged that the Clearing Supervision Act reflects Congressional recognition that multilateral clearing or settlement activities ''may reduce risks for clearing participants and the broader financial system,'' but also may create ''new risks that require multilateral payment, clearing or settlement activities to be well-designed and operated in a safe and sound manner.'' Exchange Act Release No. 64017 (Mar. 3, 2014), 76 FR 14472, 14474 (Mar. 16, 2011) (''Clearing Agency Standards Proposing Release''); *see also* 12 U.S.C. 5462(9), 5463(a)(2). The Commission also recognized that the Clearing Supervision Act is designed, in part, to provide a regulatory framework to help address 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.'' *Id.*

[19] *See, e.g.,* IAWG Report, *supra* note 4, at 5–6; 2017 Treasury Report, *supra* note 15, at 81; Joint Staff Report, *supra* note 4, at 36–37.

[20] 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 https://www.newyorkfed.org/TMPG/index.html.* The TMPG is sponsored by the Federal Reserve Bank of New York. *Id.*

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

[22] G–30 Report, *supra* note 5, at 11. *See also* IAWG Report, *supra* note 4, at 5–6; Joint Staff Report, *supra* note 4, at 36–37.

[23] TMPG White Paper, *supra* note 21, at 3.

[24] *Id.*

[25] Hereafter covered clearing agencies are referred to as ''CCAs.''

[26] Covered Clearing Agency Standards Adopting Release, Exchange Act Release No. 78961 (Sep. 28, 2016), 81 FR 70786, 70839 (Oct. 13, 2016) (''CCA Standards Adopting Release''); *see also* CCA Standards Proposing Release, *supra* note 7, 79 FR at 29552.

[27] CCA Standards Proposing Release, *supra* note 7, 79 FR at 29552; *see also* CCA Standards Adopting Release, *supra* note 25, 81 FR at 70839.

[28] 17 CFR 240.17Ad–22(e)(18).

[29] 17 CFR 240.17Ad–22(e)(19).

Commission is proposing to amend Rule 17Ad–22(e)(18). In particular, and as set forth more fully below, the Commission believes that amending Rule 17Ad–22(e)(18) to require the CCAs to address their direct participants' non-centrally cleared transactions, both for repos and certain categories of cash transactions, will 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. As discussed further in section III.A.3 *infra,* these benefits include centralized default management, increased multilateral netting, and reduction of settlement fails. The Commission also believes that increasing the volume of transactions submitted for central clearing is consistent with promoting the prompt and accurate clearance and settlement of securities transactions.[30]

The Commission also proposes to impose 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. As set forth in more detail below, the Commission believes that 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 market, thereby lowering systemic risk. Individually and collectively, these two proposals should further incentivize and facilitate additional central clearing.

In addition, the Commission recognizes that the proposal 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, broker-dealers are not permitted to include a debit in the customer reserve formula equal to this amount of margin or, more generally, to use customer cash or customer fully paid or excess margin securities to meet a margin requirement. To address this, the Commission proposes an amendment that, subject to certain conditions, would allow the broker-dealer to include a debit in the customer or PAB reserve formula when delivering customer cash or U.S. Treasury securities to meet the margin requirement at an entity providing CCP services in the U.S. Treasury market.

E. Current Regulatory and Industry Discussions Regarding the U.S. Treasury Market

In normal market conditions, the U.S. Treasury market has functioned extremely well. Even under stress, the market generally has been highly resilient. However, several episodes in the U.S. Treasury market, including the ''flash rally'' of 2014, the U.S. Treasury repo market stress of September 2019, and the COVID–19 shock of March 2020, have raised questions about the U.S. Treasury market's continued capacity to absorb shocks and what factors may be limiting the resilience of the U.S. Treasury market under stress.[31] 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.

A number of recent publications and industry discussions have considered the overall structure and resilience of the U.S. Treasury market, in light of, among other things, the market events noted above.[32] The Commission believes that, although this proposal will not, by itself, necessarily prevent future market disruptions, the proposal will support efficiency by reducing counterparty credit risk and improving transparency, as discussed in section III.A.3 *infra.* Moreover, the Commission believes that enhancing the membership standards applicable to U.S. Treasury securities CCAs should improve the resilience of such CCAs by expanding their ability to manage the risks arising from direct participants who currently engage in non-centrally cleared transactions away from the CCA. In addition, the Commission believes that the risk management standards should facilitate and incentivize additional central clearing, thereby bringing the benefits of additional central clearing to the market for U.S. Treasury securities.

The Commission believes that these changes should lower systemic risk in the U.S. Treasury market by increasing the volume of transactions that are subject to central clearing and ensuring that those additional transactions are subject to standardized risk management. The Commission also believes that increased central clearing would provide greater transparency into the market and could, potentially facilitate all-to-all trading.[33] The Commission believes that these benefits arising from central clearing should help improve the functioning of the U.S. Treasury market.

II. Background

A. Current U.S. Treasury Market Structure and Central Clearing Within That Structure

U.S. Treasury securities are direct obligations of the U.S. Government issued by the U.S. Department of the Treasury (''Treasury Department''). Market participants use U.S. Treasury securities as an investment instrument and as a hedging vehicle, among other things. For example, U.S. Treasury securities are often used as collateral in lending arrangements or as margin on other financial transactions. The Treasury Department issues several different types of securities, including U.S. Treasury bills, nominal coupons notes and bonds, Floating Rate Notes, and Treasury Inflation-Protected Securities (''TIPS''). For each U.S. Treasury security type, the most recently issued (''on-the-run'') securities are the most liquid in the secondary market.[34] Market participants commonly refer to securities issued prior to ''on-the-run'' securities as ''off-the-run'' securities. Trading in off-the-run U.S. Treasury securities has always been less active than on-the-run trading, and price discovery primarily occurs in on-the-run securities.[35]

The U.S. Treasury market consists of two components: the primary market

[30] *See* 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.'').

[31] G–30 Report, *supra* note 5, at 1; IAWG Report, *supra* note 4, at 7; Peter Ryan and Robert Toomey, *Improving Capacity and Resiliency in US Treasury Markets: Part I* (Mar. 24, 2021), *available at https://www.sifma.org/resources/news/improving-capacity-and-resiliency-in-us-treasury-markets-part-1/.*

[32] *See generally* IAWG Report, *supra* note 4; G–30 Report, *supra* note 5; Nellie Liang & Patrick Parkinson, *Enhancing Liquidity of the U.S. Treasury Market Under Stress* (Dec. 16, 2020), *available at https://www.brookings.edu/wp-content/uploads/2020/12/WP72_Liang-Parkinson.pdf* (''Liang & Parkinson'').

[33] *See* notes 184 through 186 *infra.*

[34] 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.

[35] Joint Staff Report, *supra* note 4, at 35–36. Price discovery also occurs in when-issued trading of U.S. Treasury securities prior to and on the day of the auction (pre- on-the-run trading). *See* note 38 *infra.*

and the secondary market. The primary market is where 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.[36] These U.S. Treasury securities, which are issued after the auction, are marketable securities and are primarily sold to financial institutions. 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.[37] U.S. Treasury securities are typically issued a few days after the auction and trade on the secondary market.[38] The secondary market is where the subsequent trading of U.S. Treasury securities occurs. 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 participant, along with a commitment to repurchase the security at a specified price on a specified later date.[39] This proposal applies to the secondary market for U.S. Treasury securities.

1. 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. The majority of trading in the interdealer market in on-the-run U.S. Treasury securities occurs on electronic platforms operated by interdealer brokers that bring together buyers and sellers anonymously using order books or other trading facilities supported by advanced electronic trading technology (''IDBs'').[40] 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.[41]

Typically, an IDB provides 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 to all users on an anonymous basis. The trading facility automatically matches these orders according to priority and execution rules that are programmed in the trading facility. When a match occurs and 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 counterparty.[42]

Although the term ''IDB'' is sometimes used to refer to platforms that may provide voice-based or other trading technology, as referenced below, in this release, consistent with existing commentary on the U.S. Treasury markets, the term IDB does not encompass platforms that provide voice-based or other non-anonymous methods of bringing together buyers and sellers of U.S. Treasury securities and instead refers to electronic platforms providing anonymous methods of bringing together buyers and sellers.[43]

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.[44]

Until the mid-2000s, most interdealer trading occurred between primary dealers, who are required to be members of FICC, and was centrally cleared.[45] However, in recent years, much of the trading on IDBs, in terms of number of trades and overall volume, has been conducted by PTFs.[46]

Most IDBs are FICC direct participants, and the trades between an IDB, that is a FICC direct participant, and another FICC direct participant are submitted for central clearing to FICC, which, as noted above, is currently the only U.S. Treasury securities CCA. Various types of market participants are direct participants of FICC, including dealers (both bank-affiliated and independent), banks, and IDBs. FICC's current rules generally require that FICC direct participants submit for clearing all trades with other FICC direct participants.[47] 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 which 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

[36] TMPG White Paper, *supra* note 21, 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.

[37] *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, which may also participate in the Treasury market, as discussed further in section II.A.1 and 2 *infra.*

[38] 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. Michael Fleming, Or Shachar, and Peter Van Tassel, Treasury Market When-Issued Trading Activity, Liberty Street Economics (Nov. 30, 2020) (''Fleming, Shachar, and Van Tassel''), *available at https://libertystreeteconomics.newyorkfed.org/2020/11/treasury-market-when-issued-trading-activity/.*

[39] *See* 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 and are not the subject of this proposal.

[40] Joint Staff Report, *supra* note 4, at 11, 35–36.

[41] IAWG Report, *supra* note 4, at 21.

[42] TMPG White Paper, *supra* note 21, at 6.

[43] The entities referred to as IDBs here are encompassed in the ATSs category in the tables set forth in section IV.B.1 *infra* 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.

[44] Joint Staff Report, *supra* note 4, at 35.

[45] G–30 Report, *supra* note 5, at 9; IAWG Report, *supra* note 4, at 5–6; TMPG White Paper, *supra* note 21, at 6. *See also supra* note 37 (setting forth conditions for being a primary dealer).

[46] G–30 Report, *supra* note 5, at 1.

[47] 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). The Rules for FICC's GSD are available at *https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.* Unless otherwise indicated, all references to ''FICC Rule'' in this release refer to the GSD Rulebook.

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.[48]

A 2015 inter-agency staff publication found that PTFs account for more than half of the trading activity in the futures and electronic IDB markets for U.S. Treasury securities, providing the vast majority of market depth, and questioned whether trades cleared by such firms outside of a CCP are subject to the same level of risk mitigation.[49] In 2018, the TMPG determined that ''a majority of trades in the secondary [cash] Treasury market now clear bilaterally, a trend that is contrary to the direction of recent regulatory requirements in other markets (*i.e.,* swaps) that for some products mandate clearing and for others encourage it through higher margin requirements on bilaterally cleared transactions.'' [50] The trading volume of non-FICC members, at least in the cash U.S. Treasury market, is now estimated to exceed that of FICC members.[51] Whether or not a trade is centrally cleared impacts the risk management requirements applicable to the trade. Specifically, trades cleared and settled outside of a CCP may not be subject to the same extent 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 management.[52]

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 section IV *infra* as non-ATS IDBs).[53] 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.[54] 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.[55]

2. U.S. Treasury Repo Market

In a U.S. Treasury repo transaction, one party sells a U.S. Treasury security to another party, along with a commitment to repurchase the security at a specified price on a specified later date. A reverse repo transaction is the same transaction from the buyer's perspective.[56] The effect of such a repo transaction is similar to a cash loan, using the U.S. Treasury securities as collateral. The difference in price between the purchase and repurchase is typically converted to an interest rate, and represents the ''cost'' of the loan. U.S. Treasury repos can use a particular security as collateral (known in the industry as ''specific collateral'') or can designate a broad class of securities as collateral (known as ''general collateral''). Most U.S. Treasury repos are overnight, though the parties can set the term for longer (generally no longer than one year).

The U.S. Treasury repo market plays a key role in facilitating the flow of cash and securities in the financial system by allowing market participants to access low cost secured financing, supporting dealer market-making activities, enabling institutional investors with large cash balances to invest cash on a secured basis, and contributing to price discovery and efficient capital allocation.[57] The Federal Reserve also engages in U.S. Treasury repos to bring about liquidity in the financial system, implement monetary policy, and promote financial stability. As of March 31, 2022, total repo assets were approximately $6 trillion, while repo liabilities were approximately $5.6 trillion, with over half collateralized by U.S. Treasury securities.[58] Of that amount, 38 percent is attributable to the Federal Reserve's reverse repo programs, 27 percent to securities dealers, 20 percent to what is referred to as ''rest of world'' and includes, among other entities, foreign hedge funds, and the rest to banks, mortgage real estate investment trusts, and insurance companies.[59]

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 on a triparty platform.

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 involve at least one party that is not a FICC direct participant (*e.g.,* a hedge fund); such repos may also involve a repo structure that FICC does not accept for clearing.

For centrally cleared bilateral U.S. Treasury repos, the parties are FICC direct participants that submit 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.[60] Additionally, some institutional participants (*e.g.,* money market funds and hedge funds) that are not FICC direct participants also centrally clear repos through FICC's sponsored service. In 2005, FICC established this service (the ''Sponsored Service''), allowing eligible direct participants (Sponsoring Members) to sponsor their clients into a limited form of FICC membership and then to submit certain eligible securities transactions of their clients (Sponsored Members) to FICC for central clearing.[61] 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

[48] *See* TMPG White Paper, *supra* note 21, at Figures 5A and 5B (providing graphical description of this type of clearing).

[49] Joint Staff Report, *supra* note 4, at 2, 55.

[50] TMPG White Paper, *supra* note 21, at 2.

[51] IAWG Report, *supra* note 4, at 30; TMPG White Paper, *supra* note 21, at 12.

[52] IAWG Report, *supra* note 4, at 30; G–30 Report, *supra* note 5.

[53] G–30 Report, *supra* note 5, at 1; TMPG White Paper, *supra* note 21, at 1–2.

[54] *See* Exchange Act Release No. 90019 (Sep. 28, 2020), 85 FR 87106, 87108 (Dec. 30, 2020).

[55] G–30 Report, *supra* note 5, at 1; IAWG Report, *supra* note 4, at 3; TMPG White Paper, *supra* note 21, at 6.

[56] For purposes of this release, we generally refer to both repos and reverse repos collectively as ''repos.''

[57] 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'').

[58] The Financial Accounts of the United States (Q1 2022), *available at https://www.federalreserve.gov/releases/z1/20220609/html/l207.htm.* The difference between repo assets and repo liabilities in the Financial Accounts is largely attributed to incomplete repo data collections and is calculated as instrument discrepancies.

[59] *See id.*

[60] *See* note 249 *infra.*

[61] *See* Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change Establishing a Sponsored Membership Program, Exchange Act Release No. 51896 (June 21, 2005), 70 FR 36981 (June 27, 2005).

Members.[62] Sponsoring Members can be either bank direct participants of FICC which meet certain capital and other requirements or any other FICC direct participant which meets what FICC determines to be the appropriate financial resource requirements; in practice, Sponsoring Members include both banks and broker-dealers.[63] Sponsored Members have to be ''qualified institutional buyers'' as defined by Rule 144A under the Securities Act of 1933, as amended, or 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.[64]

For non-centrally cleared triparty U.S. Treasury repos, cash lenders (*e.g.,* money market funds) provide financing to 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.[65]

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 by 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, *i.e.,* between two direct members of FICC. However, in September 2021, FICC introduced its Sponsored General Collateral Service (''Sponsored GC Service''), which enables centrally cleared triparty repos between a sponsored member and its sponsoring member.[66] 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.[67] Each type of eligible collateral for the Sponsored GC Service is assigned its own generic CUSIP number, and security types are not mixed.[68]

B. Current Regulatory Framework

1. Clearing Agency Regulation Under Section 17A of the Exchange Act

As noted above, 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,[69] and the Government Securities Act of 1986 specifically included government securities within the scope of section 17A.[70] In facilitating the establishment of the national clearance and settlement system, the Commission must have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.[71] The Commission's ability to achieve these goals is based upon the regulation of clearing agencies registered with the Commission.[72] Specifically, section 17A of the Exchange Act provides the Commission with authority to adopt rules as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act (including for the prompt and accurate clearance and settlement of securities transactions) and prohibits a clearing agency from engaging in any activity in contravention of such rules and regulations.[73]

The Commission has exercised its broad authority to prescribe requirements for the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds described above. As noted above, most recently, the Commission has promulgated the Covered Clearing Agency standards, which apply to, among others, any entity providing CCP services, such as FICC.[74] These standards require covered clearing agencies, to establish, implement, maintain, and enforce written policies and procedures reasonably designed to, as applicable, meet certain minimum standards regarding, among other things, operations, governance, and risk management.

The Commission has previously explained that membership requirements like those set forth in this proposal are an important tool for managing a clearing agency's risk. For example, when proposing the Covered Clearing Agency Standards, the Commission explained that appropriate minimum membership requirements, including operational, legal, and capital requirements, help ''to ensure all

[62] *See* Exchange Act Release No. 51896 (June 21, 2005), 70 FR 36981 (June 27, 2005); *see also* FICC Rule 3A, *supra* note 47. For general information and statistics regarding the Sponsored Service, see *https://www.dtcc.com/clearing-services/ficc-gov/sponsored-membership,* as well as section 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.

[63] *See* FICC Rule 3A, section 2(a) and (b), *supra* note 47; FICC Membership Listing, *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).

[64] *See* FICC Rule 3A, section 3(a), *supra* note 47; FICC Sponsored Membership Listing, *available at https://www.dtcc.com/client-center/ficc-gov-directories.*

[65] *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.*

[66] 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.

[67] *See generally* DTCC Sponsored General Collateral Service, *available at https://www.dtcc.com/-/media/Files/Downloads/Clearing-Services/FICC/GOV/SponsoredGC-FS-INTL.pdf.*

[68] *Id.*

[69] *See supra* note 1.

[70] Specifically, the Government Securities Act, among other things, authorized the Commission to regulate clearing agencies engaged in the clearance and settlement of government securities transactions, including those in U.S. Treasury securities, by providing that government securities would no longer be exempt securities for purposes of section 17A of the Exchange Act. Government Securities Act of 1986, section 102(a); 15 U.S.C. 78c(a)(12)(B)(i).

[71] *See* 15 U.S.C. 78q–1(a)(2)(A).

[72] Under the Exchange Act and the regulations thereunder, any entity providing such central counterparty services is a clearing agency and must register with the Commission or seek an exemption from registration. 15 U.S.C. 78q–1(b)(1); *see also* 17 CFR 240.17Ad–22(a)(5) (defining covered clearing agency).

[73] *See* 15 U.S.C. 78q–1(d)(1); *see also* 15 U.S.C. 78q–1(b)(2) (referring to the Commission's ability to adopt rules with respect to the application of section 17A). As noted above, for purposes of section 17A, the Commission's authority over securities also includes ''government securities.'' Government Securities Act of 1986, section 102(a); 15 U.S.C. 78c(a)(12)(B)(i).

[74] *See supra* note 7 and 17 CFR 240.17Ad–22(a)(5).

members will be reasonably capable of meeting their various obligations to the clearing agency in stressed market conditions and upon member default.'' [75] Clearing agency member defaults have long been a concern of the Commission; the Commission has explained that ''[m]ember defaults challenge the safe functioning of a clearing agency by creating credit and liquidity risks, which impede a clearing agency's ability to settle securities transactions in a timely manner.'' [76]

In particular, among other things, the Covered Clearing Agency Standards impose requirements on a covered clearing agency with respect to both its direct and indirect participants. For example, Rule 17Ad–22(e)(18) requires that covered clearing agencies establish implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, establish objective, risk-based and publicly disclosed criteria for participation.[77] Similarly, Rule 17Ad–22(e)(19) imposes requirements on a covered clearing agency to maintain written policies and procedures reasonably designed to, as applicable, identify, monitor and manage the risks posed to it by indirect participants.[78]

2. The Broker-Dealer Customer Protection Rule

Rule 15c3–3 is designed ''to give more specific protection to customer funds and securities, in effect forbidding brokers and dealers from using customer assets to finance any part of their businesses unrelated to servicing securities customers; *e.g.,* a firm is virtually precluded from using customer funds to buy securities for its own account.'' [79] To meet this objective, Rule 15c3–3 requires a broker-dealer that maintains custody of customer securities and cash (a ''carrying broker-dealer'') to take two primary steps to safeguard these assets, as described below. The steps are designed to protect customers by segregating their securities and cash from the broker-dealer's proprietary business activities. If the broker-dealer fails financially, the customer securities and cash should be readily available to be returned to the customers. In addition, if the failed broker-dealer is liquidated in a formal proceeding under the Securities Investor Protection Act of 1970 (''SIPA''), the customer securities and cash should be isolated and readily identifiable as ''customer property'' and, consequently, available to be distributed to customers ahead of other creditors.[80]

The first step required by Rule 15c3–3 is that a carrying broker-dealer must maintain physical possession or control over customers' fully paid and excess margin securities.[81] Control means the broker-dealer must hold these securities in one of several locations specified in Rule 15c3–3 and free of liens or any other interest that could be exercised by a third-party to secure an obligation of the broker-dealer.[82] Permissible locations include a clearing corporation and a bank, as defined in section 3(a)(6) of the Exchange Act.[83]

The second step is that a carrying broker-dealer must maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers.[84] The account must be titled ''Special Reserve Bank Account for the Exclusive Benefit of Customers'' (''customer reserve account'').[85] The amount of net cash owed to customers is computed weekly pursuant to a formula set forth in 17 CFR 240.15c3–3a (''Rule 15c3–3a'').[86] Under the formula, the broker-dealer adds up customer credit items and then subtracts from that amount customer debit items.[87] The credit items include credit balances in customer accounts and funds obtained through the use of customer securities.[88] The debit items include money owed by customers (*e.g.,* from margin lending), securities borrowed by the broker-dealer to effectuate customer short sales, and required margin posted to certain clearing agencies as a consequence of customer securities transactions.[89] If credit items exceed debit items, the net amount must be on deposit in the customer reserve account in the form of

[75] CCA Standards Proposing Release, *supra* note 7, 79 FR at 29552; *see also* CCA Standards Adopting Release, *supra* note 25, 81 FR at 70839 (stating that the use of risk-based criteria helps to protect investors ''by limiting the participants of a covered clearing agency to those for which the covered clearing agency has assessed the likelihood of default.'').

[76] CCA Standards Proposing Release, *supra* note 7, 79 FR at 29552.

[77] 17 CFR 240.17Ad–22(e)(18).

[78] 17 CFR 240.17Ad–22(e)(19).

[79] *See* Exchange Act Release No. 21651 (Jan. 11, 1985), 50 FR 2690, 2690 (Jan. 18, 1985). *See also* Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224, 25224 (Nov. 29, 1972).

[80] *See* 15 U.S.C. 78aaa *et seq.* At a high level, in such a liquidation, SIPA would provide for the appointment of a trustee, who is required to return customer name securities to customers of the debtor (15 U.S.C. 78fff–2(c)(2)), distribute the fund of ''customer property'' ratably to customers (15 U.S.C. 78fff–2(b)), and pay, with money from the SIPC fund, remaining customer net equity claims, to the extent provided by the Act (15 U.S.C. 78fff–2(b) and 3(a)). Customer property is defined as ''cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted.'' 15 U.S.C. 7*lll*(4).

[81] *See* 17 CFR 240.15c3–3(d). The term ''fully paid securities'' means all securities carried for the account of a customer in a cash account as defined in Regulation T (12 CFR 220.1 *et seq.*), as well as securities carried for the account of a customer in a margin account or any special account under Regulation T that have no loan value for margin purposes, and all margin equity securities in such accounts if they are fully paid: provided, however, that the term fully paid securities does not apply to any securities purchased in transactions for which the customer has not made full payment. 17 CFR 240.15c3–3(a)(3). The term ''margin securities'' means those securities carried for the account of a customer in a margin account as defined in section 4 of Regulation T (12 CFR 220.4), as well as securities carried in any other account (such accounts referred to as ''margin accounts'') other than the securities referred to in paragraph (a)(3) of Rule 15c3–3. 17 CFR 240.15c3–3(a)(4). The term ''excess margin securities'' means those securities referred to in paragraph (a)(4) of Rule 15c3–3 carried for the account of a customer having a market value in excess of 140% of the total of the debit balances in the customer's account or accounts encompassed by paragraph (a)(4) of Rule 15c3–3 which the broker-dealer identifies as not constituting margin securities. 17 CFR 240.15c3–3(a)(5).

[82] *See* 17 CFR 240.15c3–3(c). Customer securities held by the carrying broker-dealer are not assets of the firm. Rather, the carrying broker-dealer holds them in a custodial capacity, and the possession and control requirement is designed to ensure that the carrying broker-dealer treats them in a manner that allows for their prompt return.

[83] *Id.*

[84] 17 CFR 240.15c3–3(e). The term ''qualified security'' is defined in Rule 15c3–3 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. *See* 17 CFR 240.15c3–3(a)(6).

[85] *See* 17 CFR 240.15c3–3(e)(1). The purpose of giving the account this title is to alert the bank and creditors of the broker-dealer that this reserve fund is to be used to meet the broker-dealer's obligations to customers (and not the claims of general creditors) in the event the broker-dealer must be liquidated in a formal proceeding.

[86] Some broker-dealers perform a daily computation in order to more dynamically match the deposit requirement with the amount of net cash owed to customers. For example, a broker-dealer that performs a weekly computation generally cannot withdraw excess cash or U.S. Treasury securities from the account until the following week even if the value of the account assets exceeds the net cash owed to customers. Further, the rule permits certain broker-dealers to perform a monthly computation. *See* 17 CFR 240.15c3–3(e)(3).

[87] *See id.*

[88] *See* 17 CFR 240.15c3–3a, Items 1–9. Broker-dealers are permitted to use customer margin securities to, for example, obtain bank loans to finance the funds used to lend to customers to purchase the securities. The amount of the bank loan is a credit in the formula because this is the amount that the broker-dealer would need to pay the bank to retrieve the securities. Similarly, broker-dealers may use customer margin securities to make stock loans to other broker-dealers in which the lending broker-dealer typically receives cash in return. The amount payable to the other broker-dealer on the stock loan is a credit in the formula because this is the amount the broker-dealer would need to pay the other broker-dealer to retrieve the securities.

[89] *See* 17 CFR 240.15c3–3a, Items 10–14.

cash and/or qualified securities.[90] A broker-dealer cannot make a withdrawal from the customer reserve account until the next computation and even then only if the computation shows that the reserve requirement has decreased.[91] The broker-dealer must make a deposit into the customer reserve account if the computation shows an increase in the reserve requirement.

The Rule 15c3–3a formula permits the broker-dealer to offset customer credit items only with customer debit items.[92] This means the broker-dealer can use customer cash to facilitate customer transactions such as financing customer margin loans and borrowing securities to make deliveries of securities customers have sold short.[93] The broker-dealer margin rules require securities customers to maintain a minimum level of equity in their securities accounts. In addition to protecting the broker-dealer from the consequences of a customer default, this equity serves to over-collateralize the customers' obligations to the broker-dealer. This buffer protects the customers whose cash was used to facilitate the broker-dealer's financing of securities purchases. 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.[94] 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. Treasury 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).[95]

As noted above, debit items in the Rule 15c3–3a formula include margin required and on deposit at certain clearing agencies. In particular, Item 13 of the Rule 15c3–3a formula identifies as a debit item margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in accounts of securities customers.[96] Similarly, Item 14 of the Rule 15c3–3a formula identifies as a debit item margin related to security futures products written, purchased, or sold in accounts carried for security-based swap customers required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act[97] or a derivatives clearing organization (''DCO'') registered with the Commodities Futures Trading Commission under section 5b of the Commodity Exchange Act.[98] These debit items reflect the fact that customer options and security futures transactions that are cleared generate margin requirements in which the broker-dealer must deliver collateral to the Options Clearing Corporation in the case of options or a clearing agency or DCO in the case of security futures products. Further, 17 CFR 240.15c3–3b (''Rule 15c3–3b'') sets forth a customer reserve formula for security-based swaps.[99] Items 13 and 14 of this formula are identical to Items 13 and 14 of the Rule 15c3–3a formula. The Rule 15c3–3b formula also permits a debit item for margin related to cleared security-based swaps required and on deposit in a qualified clearing agency account at a clearing agency registered pursuant to section 17A of the Exchange Act.

Identifying the collateral delivered to the Options Clearing Corporation, a clearing agency, or a DCO as a debit item permits the broker-dealer to offset credit items, which reduces the amount of cash or qualified securities that must be deposited in the customer reserve account. In addition, under SIPA, ''customer property'' in a liquidation proceeding of a broker-dealer includes resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as defined by the Commission by rule.[100] Therefore, by defining margin required and on deposit at the Options Clearing Corporation, a clearing agency, or a DCO as a debit item in Rule 15c3–3a, this property is available to the trustee to be used to return cash and securities to the failed broker-dealer's customers ahead of any other creditors of the broker-dealer.

III. Proposed Amendments

A. U.S. Treasury Securities CCA Membership Requirements

For the reasons set forth below, the Commission believes that direct participants in a U.S. Treasury securities CCA not centrally clearing cash or repo transactions in U.S. Treasury securities creates contagion risk to CCAs clearing and settling in these markets, as well as to the market as a whole, and that this contagion risk can be ameliorated at least in part by increasing the number of such transactions that are centrally cleared. Currently, the only U.S. Treasury securities CCA requires its direct participants to submit for central clearing are their cash and repo transactions in U.S. Treasury securities with other direct participants.[101] However, the CCA's rules do not require its direct participants to submit either cash or repo transactions[102] with

[90] 17 CFR 240.15c3–3(e). Customer cash is a balance sheet item of the carrying broker-dealer (*i.e.,* the amount of cash received from a customer increases the amount of the carrying broker-dealer's assets and creates a corresponding liability to the customer). The reserve formula is designed to isolate these broker-dealer assets so that an amount equal to the net liabilities to customers is held as a reserve in the form of cash or U.S. Government securities. The requirement to establish this reserve is designed to effectively prevent the carrying broker-dealer from using customer funds for proprietary business activities such as investing in securities. The goal is to put the carrying broker-dealer in a position to be able to readily meet its cash obligations to customers by requiring the firm to make deposits of cash and/or U.S. Government securities into the customer reserve account in the amount of the net cash owed to customers.

[91] *See* 17 CFR 240.15c3–3(e).

[92] *See* 17 CFR 240.15c3–3a.

[93] For example, if a broker-dealer holds $100 for customer A, the broker-dealer can use that $100 to finance a security purchase of customer B. The $100 the broker-dealer owes customer A is a credit in the formula and the $100 customer B owes the broker-dealer is a debit in the formula. Therefore, under the Rule 15c3–3a formula there would be no requirement to maintain cash and/or U.S. Government securities in the customer reserve account. However, if the broker-dealer did not use the $100 held in customer A's account for this purpose, there would be no offsetting debit and, consequently, the broker-dealer would need to have on deposit in the customer reserve account cash and/or U.S. Government securities in an amount at least equal to $100.

[94] 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.

[95] *See* 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).'').

[96] *See* 17 CFR 240.15c3–3a, Item 13.

[97] 15 U.S.C. 78q–1.

[98] 7 U.S.C. 78q–1.

[99] *See also* Exchange Act Release No. 86175 (Jun. 21, 2019), 84 FR 43872, 43938–42 (Aug. 22, 2019) (adopting a reserve computation for security-based swaps that permits a debit for margin delivered to a security-based swap clearing agency).

[100] *See* 15 U.S.C. 78*lll*(4)(B).

[101] FICC Rule 2A, section 7(e), *supra* note 47 (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).

[102] 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 Membership Proposal is limited to eligible secondary market transactions in U.S. Treasury

Continued

persons who are not direct participants for central clearing. The Commission now proposes to amend the Covered Clearing Agency Standards to impose additional requirements for any covered clearing agency that provides central counterparty services for transactions in U.S. Treasury securities regarding membership in such CCA.

Specifically, the proposal would require that such CCAs establish 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 eligible secondary market transactions to which they are a counterparty. As described in more detail below, an eligible secondary market transaction in U.S. Treasury securities would be defined to 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.

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. In addition, the proposal would require that such CCAs establish written policies and procedures reasonably designed to, as applicable, identify and monitor their direct participants' submission of transactions for clearing, including how the CCA would address a failure to submit transactions.

For the reasons set forth below, the Commission believes that taking these incremental steps, which build on the existing rules of the only U.S. Treasury securities CCA, will strengthen risk management at the current and any other future U.S. Treasury securities CCA. Further, the Commission believes that this proposal would bring the benefits of clearance and settlement to a potentially significant portion of the U.S. Treasury securities market.

This section first explains what the Membership Proposal is and to whom and what aspects of the U.S. Treasury markets it applies.[103] It then describes what constitutes an eligible secondary market transaction and what transactions are excluded from that definition. Finally, it discusses the benefits of the Membership Proposal.

1. Requirement To Clear Eligible Secondary Market Transactions

The Membership Proposal would apply to ''direct participants'' in a U.S. Treasury securities CCA, which would distinguish 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.'' [104] For purposes of the Covered Clearing Agency Standards, ''participants'' of a CCA are referred to as ''members'' or ''direct participants'' to differentiate these entities from ''direct participants' customers'' or ''indirect participants.'' [105]

Consequently, for purposes of this proposal and consistent with the terminology already used in the Covered Clearing Agency Standards,[106] the term ''direct participants'' would refer 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).[107]

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 participants'' within the meaning of this proposal and the terminology used in the Covered Clearing Agency Standards.[108]

2. Eligible Secondary Market Transactions

As discussed further below, the Commission would also define what constitutes an eligible secondary market transaction in U.S. Treasury securities subject to the Membership Proposal.[109] This definition would apply to all types of transactions that are of a type currently accepted for clearing at a U.S. Treasury securities CCA; it would not impose a requirement on a U.S.

securities, it would not apply to Sponsored GC Repo generic CUSIPs that do not include U.S. Treasury securities.

[103] The Commission would add this requirement to the current text of Rule 17Ad–22(e)(18). The Commission is also proposing to adjust the numbering of Rule 17Ad–22(e)(18), 17 CFR 240.17Ad–22(e)(18). But other than adding this proposal as new Rule 17Ad–22(e)(18)(iv), the Commission is not proposing any other substantive changes to the current text of Rule 17Ad–22(e)(18). The other changes to Rule 17Ad–22(e)(18) are entirely stylistic and designed to enhance readability in light of the proposed addition of Rule 17Ad–22(e)(18)(iv). In addition, the Commission proposes to define a U.S. Treasury security as ''any security issued by the U.S. Department of the Treasury.'' This term is not currently defined in Rule 17Ad–22, and this definition would be codified as Rule 17Ad–22(a)(23).

[104] 17 CFR 240.17Ad–22(e)(18) and (19). *See also* CCA Standards Proposing Release, *supra* note 7, 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).

[105] *See, e.g.,* 17 CFR 240.14Ad–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.*

[106] *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'').

[107] For example, FICC maintains the Sponsored Service. *See supra* notes 64 through 66 and accompanying text. 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.''

[108] 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 47. 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 this proposed requirement.

[109] The Commission proposes to define the scope of an ''eligible secondary market transaction,'' including transactions that would be excluded from that definition, in Proposed Rule 17Ad–22(a).

Treasury securities CCA to offer additional products for clearing.

The proposal 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. By statute, the Treasury Department is authorized to borrow money on behalf of the Federal government through the sale and issuance of U.S. Treasury securities to the public.[110] The terms and conditions for the sale and issuance for these securities are contained in the applicable Treasury Department auction rules or the securities offering (or auction) announcements.[111] The Treasury Department determines when auctions will occur and in what amounts and retains discretion as to the conduct of auctions, including, among other things, whether to award more or less than the amount of securities specified in an auction announcement and reserves the right to modify the terms and conditions of an auction.[112] In addition, the Treasury Department gives successful bidders the option of instructing that ''delivery and payment be made through the clearing corporation for securities awarded to the submitter for its own account, but it does not require the use of a clearing corporation for delivery and payment in connection with securities awarded in the auctions.[113] In light of the existing regulatory regime for these primary market transactions, as well as the role of such transactions in directly financing the Federal government, the Commission believes that it would be inappropriate for the Membership Proposal to include primary market transactions.

As stated above, [114] U.S. Treasury securities start trading after the auction announcement, before the auction and continue trading through issuance and afterwards. The trading that occurs after announcement and prior to issuance is generally referred to as when-issued trading and it covers two distinct periods: before the auction and after the auction. The latter, *i.e.,* when-issued trades that occur the day after the auction are considered on-the-run on some IDBs. All when-issued transactions are reported to TRACE.[115] In addition, based on its supervisory experience, the Commission understands that FICC already clears when-issued securities. Accordingly, in light of the fact that trading in when issued securities that takes place the day after the auction shares similar characteristics to secondary market transactions and such trading is already reported as a secondary market transaction, the Membership Proposal 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 section III.A.2 *infra.* However, since when-issued trading that takes place before and including 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 Membership Proposal.

a. Repo Transactions

The Commission proposes to include all U.S. Treasury repurchase and reverse repurchase agreements entered into by a direct participant of a U.S. Treasury securities CCA as eligible secondary market transactions subject to the Membership Proposal, subject to the exclusions discussed in section III.A.2.c *infra.*[116] As noted above, the U.S. Treasury repo market plays a key role in facilitating the flow of cash and securities in the financial system by allowing market participants to access financing, supporting dealer market-making activities, enabling institutional investors with large cash balances to invest cash on a secured basis, and contributing to price discovery and efficient capital allocation, as well as supporting the calculation of the Secured Overnight Financing Rate (''SOFR'') by the Federal Reserve Bank of New York.[117] Significant gaps persist in the coverage of transaction data in U.S. Treasury repo activity, but the available data indicates that the volume of repo transactions that are bilaterally cleared and settled remains substantial.[118] For example, recent research with respect to primary dealers indicates that 38 percent of their repo and 60 percent of their reverse repo activity is not centrally cleared, and, overall, that 20 percent of all their repo and 30 percent of their reverse repo activity is centrally cleared through FICC.[119] Nevertheless, 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.

In addition, 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.[120] Recent research indicates that for primary dealers, use of the centrally cleared bilateral repo market leads to a reduction in balance sheet allocation of approximately 20 percent relative to their total repo exposure.[121] The Commission believes that the benefit of this resulting additional balance sheet capacity could be shared by all market participants

[110] 31 U.S.C. 3101 *et seq.*

[111] Uniform Offering Circular, 31 CFR 356. The circular covers all aspects of the sale and issue of U.S. Treasury securities, including bidding, certifications, payment, determination of auction awards, and settlement.

[112] *See, e.g.,* Treasury Marketable Securities Offering Announcement Press Releases, *available at https://www.treasurydirect.gov/instit/annceresult/press/press_secannpr.htm;* 31 CFR 356.33.

[113] 31 CFR 356.17(d)(2).

[114] *See* note 38 *supra.*

[115] Trades in a security that occurred the day after it was auctioned accounted, on average, for approximately 12% of all trades in U.S. Treasury securities between July 1, 2019, and June 30, 2020, with approximately half of such trades taking place on an IDB. *Id.*

[116] *See* paragraphs (i) and (iii) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a).

[117] MMF Primer, *supra note 57; see also* Secured Overnight Financing Rate Data, *available at https://www.newyorkfed.org/markets/reference-rates/sofr.*

[118] 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); *see also* 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-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).

[119] 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. See* section IV.B.2 for a more detailed discussion of this analysis.

[120] 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.,* 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.

[121] Infante, *et al., supra* note 117.

through improved market liquidity and smooth market functioning.[122]

Moreover, it appears 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.[123] Indeed, a recent publication stated that competitive pressures in the bilaterally settled market for repo transactions have exerted downward pressure on haircuts, sometimes to zero.[124] 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.

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.[125] 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.

As discussed in section II.A.2 *supra,* many market participants have already chosen to centrally clear some of their repo transactions. FICC provides central clearing for its direct participants in both centrally cleared bilateral and triparty repo. In addition, in the Sponsored Program, FICC recently has made several changes to the program with the intent of increasing overall participation in the service and ensuring that market participants can use the service consistent with their applicable regulatory requirements and business strategies. For example, in 2021, FICC expanded the available products to allow Sponsored Members to clear triparty repos through the program,[126] in addition to the existing ability to sponsor bilateral repo into central clearing. There are now approximately 30 Sponsoring Members and 1,900 Sponsored Members with access to central clearing, including money market funds, hedge funds, and other asset managers.[127]

Recent research indicates that, as of the second quarter of 2022, money market funds held had close to $63 billion in centrally cleared U.S. Treasury repos, or 3% of their total Treasury repo volume.[128] Most of that centrally cleared repo is through FICC's Sponsored Program away from the triparty platform.[129] In addition, certain private funds participate in the centrally cleared Treasury repo market, through FICC's Sponsored Program. These firms benefit from improved ability to access the repo market and more advantageous pricing.[130] The Commission considered these currently available methods for accessing central clearing for U.S. Treasury repos for both dealers and buy-side entities when determining to propose the inclusion of repos as eligible secondary market transactions and believes that this factor further supports its determination.

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

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 stated above).[131] The Commission has identified certain categories of purchases and sales of U.S. Treasury securities that it believes should be part of the definition of an eligible secondary market transaction subject to the Membership Proposal, *i.e.,* for which U.S. Treasury securities CCAs would be obligated to impose membership rules to require clearing of such transactions, for the reasons described below. The Commission believes that including this set of transactions in the eligible secondary market definition and therefore subjecting these transactions to the Membership Proposal represents an incremental first step to address potential risks arising to a U.S. Treasury securities CCA.

i. IDB Transactions

The Commission proposes to include within the definition of an eligible secondary market transaction 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.[132] As a result, this definition will only encompass the transactions of those IDBs in the Treasury market that are direct participants of a U.S. Treasury securities CCA and stand as counterparties to both sides of each trade on their platforms.[133]

The Commission believes that this aspect of the Membership Proposal generally would result in the benefits described in section III.A.3 *infra.* Chiefly, the Commission believes that this aspect of the Membership Proposal would specifically address the potential for contagion risk associated with hybrid clearing that a number of commentators have highlighted. As explained above, 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.[134] 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

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

[123] TMPG Repo White Paper, *supra* note 118, at 1.

[124] G–30 Report, *supra* note 5, at 13.

[125] 17 CFR 240.17Ad–22(e)(6).

[126] *See, e.g., supra* note 64; 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), 84 FR 13328 (Apr. 4, 2019).

[127] *See* FICC Membership Directories, *available at https://www.dtcc.com/client-center/ficc-gov-directories.*

[128] Viktoria Baklanova *et al., 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'').

[129] *Id.*

[130] *See, e.g.,* G–30 Report, *supra* note 5, at 13 (''Buyside firms benefit because dealers are willing to intermediate cleared repos at narrower spreads, which are reflected in part in higher rates paid to buyside repo investors on cleared repos than on uncleared repos and in part in lower rates charged to repo borrowers (including hedge funds and smaller broker-dealers) on cleared repos.'').

[131] IAWG Report, *supra* note 4, at 30; *see also* TMPG White Paper, *supra* note 21, at 12.

[132] *See* paragraph (ii)(A) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a).

[133] *See* notes 40–43 and accompanying text *supra.*

[134] *See, e.g.,* TMPG White Paper, *supra* note 21, 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.

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.[135] 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. 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.[136] Including such transactions as eligible secondary market transactions subject to the Membership Proposal 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.

ii. Other Cash Transactions

The Commission proposes 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 is proposing 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.[137] 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).[138] As stated in section II.A.1 *supra,* in 2018, the TMPG determined that a majority of trades in the secondary cash Treasury market now clear bilaterally,[139] and estimated that the trading volume of non-FICC members exceeds that of FICC members.[140] As a result, the Commission believes 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.[141] In addition, registered broker-dealers, government securities brokers, or dealers that are not direct members of a U.S. Treasury securities CCA are typically ''introducing firms'' that establish mechanisms to clear and settle their transactions. For example, currently, many registered brokers and dealers rely on the correspondent clearing service provided by FICC to have a FICC member submit their transactions for clearing at FICC.[142]

The Commission believes that the benefits that would result from imposing a requirement on U.S. Treasury securities CCAs to require that their direct participants submit for clearing and settlement such transactions in which their counterparties are registered broker-dealers or government securities brokers or government securities dealers would be consistent with the benefits of central clearing set forth in section III.A.3 *infra.* Moreover, because these entities are already either part of or able to access the national system of clearance and settlement, there should be fewer obstacles to submission of such trades.

Second, the Commission proposes 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). This definition of a hedge fund is consistent with the Commission's definition of a hedge fund in Form PF.[143]

The Commission's intent in including transactions with hedge funds in the definition of an eligible market transaction is two-fold. First, hedge funds generally can engage in trading

[135] *See* 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'').

[136] TMPG White Paper, *supra* note 21, at 32; section IV.B.4 (Table 1) *infra.*

[137] *See* paragraph (ii)(B) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a). *See also* 15 U.S.C. 78o(a) and 78o–5(a) (requirement to register) and 78c(4), (5), (43), and (44) (definitions of broker, dealer, government securities dealer, and government securities broker). The Commission acknowledges that the transactions encompassed by paragraph (ii)(B) in the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) could also encompass certain transactions that would be encompassed by paragraph (ii)(A) of the same proposed definition, in the event that the direct participant is an IDB transacting with a registered broker-dealer. However, the set of transactions encompassed by paragraph (ii)(B) of the proposed definition is broader than that of paragraph (ii)(A). The Commission believes that this overlap is appropriate because these paragraphs of the proposed definition are designed to accomplish different purposes, which is not impacted by the potential overlap.

[138] *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'').*

[139] TMPG White Paper, *supra* note 21, at 2.

[140] IAWG Report, *supra* note 4, at 30; TMPG White Paper, *supra* note 21, at 12.

[141] *See supra* note 15 and TMPG Automated Trading White Paper, *supra* note 138.

[142] *See, e.g.,* FICC Rule 8 (describing the service), *supra* note 47; FICC Executing Firm Master List, *available at https://www.dtcc.com/client-center/ficc-gov-directories.*

[143] 17 CFR 279.9 (Form PF Glossary of Terms).

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. For example, the Commission observed when proposing Form PF that hedge funds often use financial institutions that may have systemic importance to obtain leverage, and that hedge funds may employ investment strategies that may use leverage, derivatives, complex structured products, and short selling in an effort to generate returns, as well as employ strategies involving high volumes of trading and concentrated investments.[144] The Commission 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.'' [145] The Commission also 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.[146]

Similarly, the FSOC acknowledged, in light of recent market events, the importance of understanding how hedge fund activities may impact the broader market, including ''how financial strain at hedge funds—particularly those with significant leverage—could create risks to financial stability, and how a reduction in financial intermediation by hedge funds during periods of market stress could exacerbate market impairment.'' [147] Thus, as a general matter, the Commission believes 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.

In addition, hedge funds are increasingly large players in the U.S. Treasury market. For example, as of the fourth quarter of 2021, the Commission's Private Funds Statistics indicated that qualifying hedge funds held aggregate gross notional exposure of $1,760 billion in U.S. Treasury securities.[148] However, qualifying hedge funds generally report central clearing of about 15 percent of their overall net asset value.[149] There has been a great deal of commentary regarding the role of hedge funds in the U.S. Treasury markets, particularly with respect to the March 2020 market events.[150] For example, the FSOC observed that hedge funds were among the three largest types of sellers of Treasury securities, materially contributing to the Treasury market disruption during this period, although not as its sole cause.[151] The IAWG staffs stated that, in March 2020, hedge funds were among the largest sellers of Treasury securities as expected price relationships broke down, highly levered positions magnified losses, and some funds faced margin calls.[152]

This demonstrates the potential contagion risk that could arise from hedge funds' activities in the U.S. Treasury market. 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 should reduce 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 result in consistent and transparent risk management being applied to such transactions, as discussed further in section III.A.3 *infra.*

The Commission believes 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 activities.[153] Including transactions with such funds within the definition of an eligible secondary market transaction should help to limit the potential

[144] 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).

[145] Form PF Proposing Release, *supra* note 144, 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).

[146] *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 firesale prices).

[147] FSOC Statement on Nonbank Financial Intermediation (Feb. 4, 2022), *available at https://home.treasury.gov/news/press-releases/jy0587.*

[148] 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.* 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).

[149] Private Funds Statistics for Q4 2021, Figure 17 (July 22, 2022), *available at https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q4.pdf.*

[150] *See generally* Ayelen Banegas *et al., 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.*

[151] FSOC Feb. 2022, *supra* note 172; *see also* IAWG, *supra* note 4, at 34.

[152] IAWG, *supra* note 4, at 34. *See also* 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.*

[153] 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.

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. Specifically, using such definition would allow the definition of an eligible secondary market transaction to include transactions between direct participants of a U.S. Treasury securities CCA and a private fund whose characteristics make it more likely that it would have an impact on systemic risk, *i.e.,* its ability to short sell and take on significant leverage. For example, as the Commission recently stated, large investment losses or a margin default involving one large highly levered hedge fund may have systemic risk implications, and large investment losses at multiple hedge funds may indicate market stress that could have systemic effects.[154] The Commission believes 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 subject to the Membership Proposal 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.

Third, the Commission proposes to include within the definition of an eligible secondary market transaction subject to the Membership Proposal 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.[155] 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.

The Commission believes that the inclusion of transactions with such accounts within the definition of an eligible secondary market transaction should allow the proposal to 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 leverage that poses a risk to U.S. Treasury securities CCA and the broader financial system. Covering such accounts would also allow for inclusion of, for example, accounts used by family offices or separately managed accounts that may use strategies more similar to those of a hedge fund. The account provider (*i.e.,* the prime broker) does not have access to, or knowledge of, the account owner's entire portfolio of assets and is limited to the assets in that particular account. Therefore, the account provider may be unable to make a counterparty whole in the event of a default by the account owner if the account has taken on significant leverage. Typically, the entity providing an account has a lien or some other priority on assets in the account to make a counterparty whole if necessary. 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.

c. Exclusions From the Definition of an Eligible Secondary Market Transaction

The Commission is proposing to 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. First, 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 proposing to exclude any transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a central bank. For similar reasons, the Commission is also proposing to exclude any 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.[156] Together, these exclusions are referred to as the ''Official Sector Exclusions.''

In addition, the Commission is also proposing to exclude transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a natural person. The Commission does not believe that such transactions should be included in light of the likely low volumes of transactions entered into by natural persons and the low potential for contagion risk arising from such transactions.

i. Official Sector Exclusions From the Membership Proposal

The Official Sector Exclusions are designed to permit domestic and international policy makers, *i.e.,* central banks, to continue to pursue important policy goals. Because these transactions should present limited to no risk of contagion to a U.S. Treasury securities CCA, the Commission believes that these exclusions are appropriate.

For purposes of the Official Sector Exclusion, the Commission proposes to define a central bank as 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). The proposed definition would also include the Bank for International Settlements (''BIS'').[157] The BIS is owned by central banks.[158] The Commission therefore believes it is appropriate to include the BIS in the definition of central bank for purposes of this proposal. The Commission proposes to define a sovereign entity as a central government (including the U.S. Government), or an agency, department, or ministry of a central government.[159] Finally, the Commission proposes to define an international financial institution 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

[154] Proposing Release, 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, 9109 (Feb. 17, 2022).

[155] *See* paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a).

[156] As discussed more fully below, these exclusions would be codified in paragraph (iii) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a).

[157] The Commission proposes to codify this definition in Proposed Rule 17Ad–22(a).

[158] *See https://www.bis.org/about/index.htm* (noting that ''the BIS is owned by 63 central banks, representing countries from around the world that together account for about 95% of world GDP'').

[159] The Commission proposes to codify this definition in Proposed Rule 17Ad–22(a).

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.[160]

The Commission believes that the proposed exclusion is appropriate to central banks because these entities are created by statute and are part of, or aligned with, a central government.[161] Further, the purpose of a central bank is generally to effectuate monetary policy for its respective nation.[162] For example, transactions in U.S. Treasury securities are an important tool in the fiscal and monetary policy of the United States, as well as other jurisdictions.[163] In particular, cash and repo transactions in U.S. Treasury securities are one of the primary tools used by the Federal Reserve Bank of New York to conduct open market transactions at the direction of the Federal Open Market Committee.[164] The System Open Market Account, which is managed by the Federal Reserve Bank of New York's System Open Market Trading Desk, is ''the largest asset on the Federal Reserve's balance sheet.''[165] In light of the key role of open market operations conducted by the Federal Reserve Bank of New York in the monetary policy of the United States, the Commission believes an exemption from the Membership Proposal is appropriate for the Federal Reserve System.[166] In particular, the Commission believes the Federal Reserve System should be free to choose the clearance and settlement mechanisms that are most appropriate to effectuating its policy objectives.

Further, the Commission believes that the Official Sector Exclusion should extend to foreign central banks, sovereign entities and international financial institutions for similar reasons and for reasons of international comity. Congress has decided to permit international financial institutions to enjoy a number of privileges and immunities from U.S. law,[167] which suggests that in these circumstances, the Commission should not place additional requirements on these institutions' transactions in U.S. Treasury securities. In addition, in light of ongoing expectations that Federal Reserve Banks and agencies of the Federal government would 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 entities, and international financial institutions.[168]

ii. Natural Person Exclusion

The Commission is also proposing to exclude from the Membership Proposal otherwise eligible secondary market transactions in U.S. Treasury securities between a direct participant of a U.S. Treasury securities CCA and a natural person. The Commission believes that such an exclusion is appropriate because natural persons generally transact in small volumes and would not present much, if any, contagion risk to a U.S. Treasury securities CCA.[169]

3. How the Membership Proposal Facilitates Prompt and Accurate Clearance and Settlement in the U.S. Treasury Market

The Commission believes that the Membership Proposal 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.

First, the Commission believes that the Membership Proposal 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, and would guarantee settlement of the trade in the event of a direct participant default.

By contrast, bilaterally cleared cash transactions in U.S. Treasury securities are subject to variable risk management methodologies in which exposures are often less mitigated with less rigorous

[160] The Commission proposes to codify this definition in Proposed Rule 17Ad–22(a). *Cf.* 17 CFR 50.76(b) (CFTC definition of international financial institution for purposes of exemptions from swap clearing requirement).

[161] The authorizing statutes generally provide that the government owns all or part of the capital stock or equity interest of the central bank. *See, e.g.,* Capital of the ECB Protocol on the Statute of the European System of Central Banks and of the European Central Bank (''ECB Protocol''), Article 28.2, *available at https://www.ecb.europa.eu/ecb/legal/pdf/en_statute_2.pdf.*

[162] *See, e.g.,* ECB Protocol Statute, *supra* note 106, Article 3.1; Bank of Japan Act, Articles 1 and 2, *available at https://www.boj.or.jp/en/about/boj_law/index.htm/#p01.*

[163] 12 U.S.C. 225a (defining goals of monetary policy); *see also https://www.federalreserve.gov/monetarypolicy/monetary-policy-what-are-its-goals-how-does-it-work.htm.*

[164] *See* Federal Reserve Bank; Monetary Policy Implementation, *available at https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation.*

[165] *Id.*

[166] Congress similarly exempted transactions in which one counterparty is a member of the Federal Reserve System from the regulation of swaps and security based swaps in Title VII of the Dodd-Frank Act. *See* 15 U.S.C. 78c(a)(68)(A) (noting that a security-based swap is a swap, as defined in 7 U.S.C. 1a(47), subject to certain other conditions); 7 U.S.C. 1a(47)(B)(ix) (excluding from the definition of swap any transaction in which one counterparty ''is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States'').

[167] *See, e.g.,* the International Organization and Immunities Act (22 U.S.C. 288) and the Foreign Sovereign Immunities Act (28 U.S.C. 1602). The United States has taken appropriate actions to implement international obligations with respect to such immunities and privileges. *See, e.g.,* International Bank for Reconstruction and Development (the ''World Bank'') and International Monetary Fund (22 U.S.C. 286g and 22 U.S.C. 286h), the European Bank for Reconstruction and Development (22 U.S.C. 290l–6), the Multilateral Investment Guarantee Agency (22 U.S.C. 290k–10), the Africa Development Bank (22 U.S.C. 290–8), the African Development Fund (22 U.S.C. 290g–7), the Asian Development Bank (22 U.S.C. 285g), the Inter-American Development Bank (22 U.S.C. 283g), the Bank for Economic Cooperation and Development in the Middle East and North Africa (22 U.S.C. 290o), and the Inter-American Investment Corporation (22 U.S.C. 283hh).

[168] For similar reasons, the CFTC has similarly determined to exempt swap transactions involving foreign central banks, sovereign entities, and international financial institutions from the statutory requirement that swap transactions be cleared with a Derivatives Clearing Organization. *See* 17 CFR 50.75, 50.76; Swap Clearing Exemptions, 85 FR 76428, 76429–30, 76432 (Nov. 30, 2020).

[169] For example, although it is not a precise indicator of activity by natural persons in the U.S. Treasury markets, the data available on household holdings of U.S. Treasury securities indicates that their activity is not significant to the overall market. *See, e.g.,* The Financial Accounts of the United States, at 119 (Q1 2022) (indicating that less than 3.1% of marketable U.S. Treasury securities are held by the household sector), *available at https://www.federalreserve.gov/releases/z1/20220609/z1.pdf.*

practices compared to CCP risk management.[170] Indeed, although various SRO margin rules provide for the collection of margin for certain transactions in U.S. Treasury securities, 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 to margin exposures than those that would be collected if a CCP margin model, like the one used at FICC, were used.[171] The Membership Proposal is designed to ameliorate these risks by requiring Treasury securities CCAs to establish policies and procedures that require their direct participants to submit for clearance and settlement their eligible secondary market transactions, which would include all repo transactions, and specified cash transactions in U.S. Treasury securities, which are most likely to pose contagion risk to a U.S. Treasury securities CCA.

In particular, the Membership Proposal 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 above.[172] In a hybrid transaction, the leg of the trade between an IDB, which is a FICC member, and a FICC member counterparty is submitted to FICC for clearance and settlement but the leg between the IDB and a non-FICC member counterparty is not.[173] Consequently, this FICC-member counterparty would no longer have exposure to the IDB and vice versa. But the IDB must settle the other leg of the trade bilaterally with its non-FICC member counterparty, and the IDB and the non-FICC member counterparty would face counterparty credit risk to each other until the transaction settles. Although this release has discussed ''hybrid clearing,'' and, more generally, contagion risk, with respect to IDB transactions, the general concept can apply more broadly, in that a FICC member's transactions that are not submitted for central clearing pose an indirect risk to the CCP as any default on a bilaterally settled transaction could impact the FICC member's financial resources and ability to meet its obligations to FICC. The Commission 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.

Second, the Commission believes that the Membership Proposal would also help any U.S. Treasury securities CCA to avoid a potential disorderly member default. When cash market transactions are cleared bilaterally, market participants typically enter into bespoke arrangements to govern clearance and settlement with each of their trading counterparties, resulting in multiple interconnected counterparty credit risk exposures. Aside from the inefficiency of multiple sets of bilateral documentation that may differ in key respects, such as the amount of margin required, the default of one counterparty can have cascading effects on multiple other market participants. 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.[174] Centralized default management is a key feature of central clearing. 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 coordination should result in more efficiency and market confidence than multiple bilateral settlements.

The Commission previously has stated that 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.[175] By contrast, as the TMPG has observed, independent management of bilateral credit risk by each participant in the clearance and settlement chain likely creates uncertainty about the levels of exposure across market participants and may make runs more likely, and 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.[176] Moreover, the high quality and credit status of U.S. Treasury securities does not eliminate the potential risk of clearing and settling these securities in the event of a default of a counterparty to a secondary market transaction. For example, if a large participant in a U.S. Treasury trade defaults, it can leave a counterparty with a short position to cover, which may take place as prices of U.S. Treasury securities move rapidly.[177] In particular, the Commission notes that the market for U.S. Treasury securities experienced stresses in 1986, 1994, and 2008, with more recent episodes detailed in the recent IAWG Report.[178]

Having a CCP drawing on its expertise to manage hedging and an orderly liquidation of the portfolio(s) of a party (or parties) in default would constitute an improvement to uncoordinated liquidations. 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

[170] TMPG White Paper, *supra* note 21, at 29.

[171] Although FINRA rules provide for the collection of margin for cash U.S. Treasury transactions, *see* FINRA Rule 4210(e)(2)(A) (setting forth margin rule for FINRA members for collection of margin on Treasuries and certain other bonds) these rules do not necessarily apply to exempt accounts, *see* FINRA Rule 4210(e)(2)(F) (permitting FINRA members not to collect margin from 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 margin collection is often less than that required pursuant to FICC's margin model.

[172] TMPG White Paper, *supra* note 21, at 8 n.11 (''IDB platforms act as blind brokers to provide anonymity to their customers. Under the blind broker model, the IDB serves as principal so what might appear to be a single trade between two customers is really two: one between the broker and the buyer and one between the broker and the seller. The buyer and seller are no longer directly exposed to each other, but both are exposed to the blind broker, and the blind broker is exposed to both buyer and seller.'').

[173] TMPG White Paper, *supra* note 21, at 9.

[174] *See* Rule 17Ad–22(e)(13) and (e)(23)(i).

[175] CCA Standards Proposing Release, *supra* note 7, 79 FR at 29545.

[176] TMPG White Paper, *supra* note 21, at 32.

[177] TMPG White Paper, *supra* note 21, at 32 and at 13 n. 17 (noting counterparty risk associated with the Long-Term Capital Management experience in 1998).

[178] IAWG Report, *supra* note 4.

tested annually.[179] This transparent and established approach to potential defaults stands in contrast to the variable practices that currently prevail in the bilateral market, which are not subject to similar regulation. For these reasons, the Commission believes that a requirement for a U.S. Treasury securities CCA to require that its direct participants submit for clearance and settlement all the transactions encompassed by the definition of an eligible secondary market transaction would help reduce the potential for disorderly defaults, and runs, thereby bolstering the health of the CCP and the market as a whole—consistent with the purpose of robust membership requirements the Commission contemplated in the Covered Clearing Agency Standards, and the Commission's statutory charge to promote the prompt and accurate clearance and settlement of securities transactions.[180]

Third, the Commission believes that the Membership Proposal 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.[181] Consistent with the Commission's previous statements in this regard, 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.[182] Others have also noted that these reductions, particularly in cash and securities flow would reduce liquidity risks associated with those settlements and counterparty credit risks associated with failures to deliver on the contractual settlement date,[183] not only for CCP members but for the CCP itself, thereby promoting the safeguarding of U.S. Treasury securities and funds in the custody or control of the CCA and increasing the likelihood of prompt and accurate clearance and settlement of such transactions. In fact, it has been suggested that additional central clearing, based on assumptions broader than the proposal set forth in this release, may have lowered dealers' daily settlement obligations in the cash market by 60 percent in the run-up and aftermath of the March 2020 U.S. Treasury market disruption and reduced settlement obligations by 70 percent during the disruption itself.[184] The reduction in exposure is not limited to the cash market. For example, it has been estimated that 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.[185]

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.[186] 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 bank capital and leverage requirements recognize the risk-reducing effects of multilateral netting of trades that CCP clearing accomplishes.[187]

Fourth, the potential benefits associated with the multilateral netting of transactions at a CCP that the Membership Proposal is designed to bring about could in turn help to unlock further improvements in U.S. Treasury market structure. 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.'' [188] Similarly, decreased counterparty credit risk—and potentially lower costs for intermediation—could result in narrower spreads, thereby enhancing market quality.[189] Moreover, 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.[190] 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.

Finally, 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.[191] 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 clearing would provide greater insight into the often opaque repo market, as discussed further in section III.A.2.a *supra,* as well as to the cash market where TRACE faces certain limitations, as discussed in section IV *infra.* Increased central clearing would also allow for a more aggregated view of market activity in one place.

[179] *See* 17 CFR 240.17Ad–22(e)(13).

[180] *See* 15 U.S.C. 78q–1(a)(2)(A).

[181] IAWG Report, *supra* note 4, at 30. For an example of multilateral netting, please see note 252 and accompanying text *infra.*

[182] Exchange Act Release No. 51908, *supra* note 30.

[183] G–30 Report, *supra* note 5, at 13; *see also* PIFS Paper, *supra* note 120, at 28–31.

[184] G–30 Report, *supra* note 5, at 13 n.21 (citing Michael Fleming & Frank Keane, Staff Report No. 964: Netting Efficiencies of Marketwide Central Clearing, Federal Reserve Bank of New York (Apr. 2021), *available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf*). However, this analysis relies upon the assumption that all dealers' purchases and sales of U.S. Treasury securities transactions would be centrally cleared and, therefore, netted; this proposal, if adopted, would not result in the same scope of central clearing, as it would apply only to eligible secondary market transactions of direct participants in a U.S. Treasury securities CCA.

[185] Office of Financial Research, *Benefits and Risks of Central Clearing in the Repo Market,* 5–6 (Mar. 9, 2017), *available at https://www.financialresearch.gov/briefs/files/OFRBr_2017_04_CCP-for-Repos.pdf.*

[186] Darrel Duffie, *Still the World's Safe Haven,* Hutchison Center on Fiscal & Monetary Policy, at 15 (June 2020), *available at https://www.brookings.edu/wp-content/uploads/2020/05/WP62_Duffie_v2.pdf* (''Duffie'').

[187] IAWG Report, *supra* note 4, at 30; Liang & Parkinson, *supra* note 32, at 9; Duffie, *supra* note 186, at 16–17.

[188] Liang & Parkinson, *supra* note 32, at 9.

[189] G–30 Report, *supra* note 5, at 13

[190] IAWG Report, *supra* note 4, at 30; Duffie, *supra* note 186, 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 32, 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.

[191] Duffie, *supra* note 186, at 15; 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'').

4. Policies and Procedures Regarding Direct Participants' Transactions

The proposal would also require that a U.S. Treasury securities CCA establish 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.[192] The Commission believes that such a requirement should help 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 Membership Proposal 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 Membership Proposal, if adopted.

The Commission believes 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, a U.S. Treasury securities CCA could seek attestation from its direct participants as to their submission of the required transactions.

The Commission believes 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 believes 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. Understanding the consequences of not complying with any Membership Proposal, if adopted, should, in turn, help incentivize compliance.

[192] *See* Proposed Rule 17Ad–22(e)(18)(iv)(B).

5. Request for Comment

The Commission generally requests comments on all aspects of the Membership Proposal. In addition, the Commission requests comments on the following specific issues, with accompanying data and analysis:

- Do commenters agree or disagree with any particular aspects of the Membership Proposal, including the definition of an eligible secondary market transaction? If so, which ones and why? If commenters disagree with any provision of the proposed rule, how should such provision be modified and why?
- Do commenters agree that transactions entered into by direct participants of a U.S. Treasury securities CCA that are not centrally cleared at the CCA present a contagion risk to the CCA, and thereby present systemic risk? Why or why not? Are there other benefits that expanded central clearing would bring that the Commission has not identified?
- Do commenters agree that the Commission should target the Membership Proposal, through the definition of an eligible secondary market transaction, at a subset of transactions entered into by direct participants of a U.S. Treasury securities CCA? Should the Commission instead require that a U.S. Treasury securities CCA adopt policies and procedures reasonably designed to require that its direct participants submit for clearance and settlement all of their transactions in U.S. Treasury securities?
- What implications would the increased transaction volume at a U.S. Treasury securities CCA have for participation in the U.S. Treasury market and for the U.S. Treasury market more broadly? For example, would the Membership Proposal help create all-to-all trading in the U.S. Treasury securities market?
- What impact would the Membership Proposal have on the liquidity risk of a U.S. Treasury securities CCA and how a Treasury securities CCA manages its liquidity risk consistent with Rule 17Ad–22(e)(7) (17 CFR 240.17Ad–22(e)(7))?[193] For example, what would be the potential impact to FICC's Capped Contingent Liquidity Facility (''CCLF'') and its participants' obligations under that requirement?[194] Are there any changes the Commission could adopt to the Membership Proposal that would, in turn, lead to a different impact on FICC's liquidity exposure and/or CCLF? As FICC, or any other U.S. Treasury securities CCA that may enter the market, considers implementing the Membership Proposal, are there actions it can take that may reduce its liquidity risk?
- More generally, what impact would the Membership Proposal have on other risks facing a U.S. Treasury securities CCA, including, for example, credit risk and operational risk, and how a U.S. Treasury securities CCA manages its liquidity risk consistent with the applicable Covered Clearing Agency Standards? Are there other changes that a U.S. Treasury securities CCA should make to expand the use of central clearing?
- In the event that a U.S. Treasury securities CCA were to offer clearance and settlement services for securities lending transactions in which U.S. Treasury securities are borrowed, should the Commission include such transactions in the definition of an eligible secondary market transaction in Proposed Rule 17Ad–22(a)? Would a failure to include such securities lending transactions in the definition of ''eligible secondary market transactions'' create opportunities for gaming or evasion of the requirements of Proposed Rule 17Ad–22(e)(18)(iv)(A)? Are there economic or other distinctions that mitigate against including securities lending transactions in the definition of an eligible secondary market transaction?
- In light of the fact that the Membership Proposal requires only a U.S. Treasury securities CCA to have written policies and procedures reasonably designed to require its direct members clear their eligible secondary market transactions, is there a risk that market participants will cease their direct participation in U.S. Treasury securities CCAs?
- Similarly, are market participants more likely to move some or all of their U.S. Treasury market activities from entities that are direct participants of a U.S. Treasury securities CCA into other affiliated entities? To what extent would a U.S. Treasury securities CCA be exposed to these other transactions? Should the Commission adopt rules to prohibit evasion of a U.S. Treasury securities CCA's membership requirements through the use of affiliates?
- Should either the repurchase, reverse repurchase, or purchase and sale transactions of certain direct participants of a U.S. Treasury securities CCA, *e.g.,* smaller or mid-sized dealers that would otherwise be subject to the Membership Proposal, be excluded from the definition of an eligible secondary

[193] 17 CFR 240.17Ad–22(e)(7).

[194] FICC Rule 22A, section 2a, *supra* note 47.

market transaction, such that a U.S. Treasury securities CCA would not need to have written policies and procedures requiring that all such direct participants' transactions in U.S. Treasury securities be cleared? If so, how would the risks described above in this release be mitigated? What criteria should be used to identify any direct participants who are excepted from Proposed Rule 17Ad–22(e)(18)(iv)(A)? Should any such exemption be subject to a gross notional value or other cap? If so, how should that cap be set? Should any exemption from the Membership Proposal be conditioned on the exchange of margin, haircuts and/or other risk management measures?

• As an alternative to the Membership Proposal, should the Commission establish volume thresholds for transactions by the direct participants of a Treasury CCA that should be submitted to the Treasury CCA for clearance and settlement? If so, what would be the appropriate volume thresholds?

• Do commenters agree that when-issued transactions that take place after the day of the auction and are considered on-the-run by some IDBs are part of the secondary market and would, therefore, be subject to the Membership Proposal, to the extent that such when-issued trades otherwise meet the definition of an eligible secondary market transaction in Proposed Rule 17Ad–22(a)? Do commenters also agree that when-issued securities transactions should not be considered part of the secondary market if they take place before and including the day of the auction? Do commenters have views more generally on whether when-issued transactions, either before, including, or after the day of the auction, are part of the primary or secondary market?

• In light of the likely additional balance sheet capacity that flows from clearing repo transactions in U.S. Treasury securities,[195] should the definition of an eligible secondary market transaction in Proposed Rule 17Ad–22(a) be limited to repo transactions? Are there any other reasons why the definition of eligible secondary market transactions in Proposed Rule 17Ad–22(a) should be limited to repo transactions? Please explain.

• As noted above, both bilateral and triparty repos are currently eligible for central clearing. Should the Commission limit Proposed Rule 17Ad–22(a) to either bilateral or triparty repo? Why or why not? Are there differences in prevailing haircuts or collateral that would make it more desirable to limit Proposed Rule 17Ad–22(a) to bilateral or triparty repo? What other considerations might be relevant to distinguishing between bilateral and triparty repo in the context of Proposed Rule 17Ad–22(a)?

• In light of the particular contagion risk posed by hybrid clearing at IDBs, should the definition of eligible secondary market transaction in Proposed Rule 17Ad–22(a) be limited to transactions—repurchase or outright purchase and sale or both—brokered by an IDB? Why or why not?

• Is the inclusion of purchase and sale transactions of a registered broker-dealer or government securities broker or government securities dealer in the definition of eligible secondary market transaction in Proposed Rule 17Ad–22(a) appropriate? Why or why not? Is the participation of the entities set forth in paragraph (ii)(B) of the proposed definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) in the national system of clearance and settlement likely to increase the potential risk their eligible secondary market transactions in U.S. Treasury securities pose to a U.S. Treasury securities CCA? Are there other reasons that participation in the national system of clearance and settlement should be the basis for being subject to the Membership Proposal? Are there other entities, *e.g.,* banks that also participate in the national system of clearance of and settlement and that should, on the same logic be included as part of paragraph (ii)(B) of the proposed definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? Do commenters have any data and/or quantification of the approximate dollar value of transactions that would be encompassed by paragraph (ii)(B) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? Are they material enough to warrant inclusion in the Membership Proposal?

• Could inclusion of transactions between a direct participant of a U.S. Treasury securities CCA and a registered broker-dealer or government securities broker or dealer in the definition of an eligible secondary market transaction result in pro- or anti-competitive effects in the market for intermediation in the market for U.S. Treasury securities, particularly as some registered broker-dealers have already highlighted that additional central clearing may affect their ability to compete with those firms with larger market share?

• Is the inclusion of the secondary market purchase and sale transactions between a direct participant of a U.S. Treasury securities CCA and a hedge fund in the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) desirable or appropriate? Why or why not? Do commenters agree that this aspect of the proposal would address the risks posed by hedge funds transacting in the U.S. Treasury market?

• Do commenters agree with the definition of a hedge fund in paragraph (ii)(C) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? If not, what should that definition be? Would a more limited definition of a hedge fund, *e.g.,* using only one of the subsections (a) through (c) of the proposed definition (and if so, which ones), be easier to administer or better targeted to reach transactions potentially posing risk to the CCA? For example, would a more limited definition that incorporated only subsection (b) of the proposed definition regarding leverage be used in paragraph (ii)(C) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) be a preferable approach?

• Should the definition of a hedge fund be limited so that, to qualify as a hedge fund under the leverage prong of the definition in subsection (b), a fund would have to continue to satisfy that subsection, but also must have actually borrowed or used any leverage during the past 12 months, excluding any borrowings secured by unfunded commitments (*i.e.,* subscription lines of credit); and/or to qualify as a hedge fund under the short selling prong of the definition in subsection (c), the fund must have actually engaged in the short selling activities described in that subsection during the past 12 months? If the Commission were to revise the proposed definition, would excluding actual borrowings secured by unfunded commitments (*i.e.,* subscription lines of credit) appropriately exclude private equity funds, which typically engage in such borrowings? Should any revised definition require actual borrowing or short selling in the last 12 months? Alternatively, should any revised definition require a longer or shorter time period, such as 18 months or nine months, or different time periods for borrowing versus short selling?

• Should the definition of a hedge fund be limited to hedge funds managed by an investment adviser registered with the Commission?

• Should the inclusion of transactions between hedge funds and direct participants of a U.S. Treasury securities CCA be limited to hedge funds of a certain size or hedge funds managed by

[195] *See supra* note 121 and accompanying text.

investment advisers of a certain size? If so, what is the appropriate threshold to use? For example, should the Commission limit the definition of a hedge fund to apply only to those with net asset value of at least $500 million? Is a fund of that size more likely to have an impact on particular markets in which it invests or on its particular counterparties? Or should the Commission limit the definition of a hedge fund to those which are managed by an investment adviser with, for example, at least $150 million in private fund assets under management?

• Instead of including a definition of a hedge fund in paragraph (ii)(C) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a), should the Commission incorporate by reference the definition of a hedge fund set forth in Form PF?

• Do commenters agree that a U.S. Treasury securities CCA should be required to adopt rules requiring that a direct participant of the CCA submit for clearing all transactions between the participant and an account at a registered broker-dealer, government securities dealer, or government securities broker where such account may borrow an 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 as described in paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? Why or why not? Do commenters agree that there is an additional benefit from capturing these additional transactions beyond those in paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)?

• Can the inclusion of particular accounts within the set of counterparties included in the definition of an eligible secondary market transaction in paragraph (ii) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) be administered by a U.S. Treasury securities CCA and/or its direct participant? Would a direct participant be able to know whether its counterparty is such an account?

• Should the particular accounts included within paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) also include accounts with banks? Why or why not?

• Do commenters agree that particular accounts identified in paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) pose (or have the potential to pose) potential contagion risk to a U.S. Treasury securities CCA as described in section III.A.3 *supra,* such that their purchase and sale transactions of secondary market U.S. Treasury securities should be included in the Membership Proposal? If so, does the definition of a specified account in paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) adequately capture the range of specified accounts that could pose (or have the potential to pose) significant system risk? If not, how should the definition of a specified account in paragraph (ii)(D) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) be adjusted to better capture this risk? For example, should the use of actual leverage in the preceding 12 months be required for such an account? Should different leverage thresholds or gross notional exposures be used? Should there be a size threshold in terms of the size of the account or the entity holding the account? Why or why not?

• Instead of identifying a particular set of eligible secondary market cash transactions in Proposed Rule 17Ad–22(a), should the Commission instead require that a U.S. Treasury securities CCA (i) require its direct participants to submit their U.S. Treasury security repurchase and reverse repurchase transactions, and (ii) in the event that a direct participant has such repurchase or reverse repurchase transactions to submit, require that the direct participant also submit its cash transactions? Would this approach be easier to administer? Would this approach capture the systemic and contagion risks to a U.S. Treasury securities CCA described above?

• Should the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) include all secondary market purchase and sale transactions by a direct participant of a U.S. Treasury securities CCA in the definition of an eligible secondary market transaction? If so, why? Would doing so materially protect U.S. Treasury CCAs from the potential risks discussed above? Would such a broad requirement have salutary effects on the market for U.S. Treasury as a whole, for example by helping to foster an all-to-all market for U.S. Treasury securities or in other ways?

• Are there other potential accounts, entities or market participants whose U.S. Treasury security purchase and sale activity as counterparties to direct participants of a U.S. Treasury securities CCA that should be included in the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? For example, should the Commission include purchase and sale activity in which the direct participant's counterparty is a registered investment company, a money market fund, or other buy-side entity? Has the Commission identified an appropriate set of purchase and sale transactions to include in the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? Why or why not? If the Commission were to include additional purchase and sale activity, should it do so in a staggered or sequenced manner?

• Are there particular purchases and sales of U.S. Treasury securities involving a direct participant of a U.S. Treasury securities CCA that the Commission should include or exclude from the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a)? Should the Commission include or exclude such transactions based on their potential to transmit risk to a U.S. Treasury securities CCA and the financial system as whole? If so, has the Commission identified the purchase and sale transactions most likely to be the source of such risk? If not, what criteria should the Commission use to identify the purchase and sale transactions that should be included or excluded?

• Is the Official Sector Exclusion to the definition of an eligible secondary market transaction appropriate? Why or why not? Does this proposed exclusion appropriately take into account transactions made on behalf of a central bank, sovereign entity, or international financial institution, *i.e.,* by an intermediary?

• Do commenters agree with the definitions of a central bank, sovereign entity, and international financial institution used in the Official Sector Exclusion? Why or why not?

• To the extent that they meet the proposed definition of a ''sovereign entity'' in Proposed Rule 17Ad–22(a), should sovereign wealth funds or other state-owned investment vehicles be removed from the Official Sector Exclusion? If so, how should these entities be defined for this purpose? Do these entities use leverage or otherwise pose risk to a U.S. Treasury securities CCA that is more similar to the entities that are subject to the Membership Proposal? Why or why not? Are there other factors the Commission should consider in deciding whether to exclude sovereign wealth funds from the Official Sector Exclusion?

• Is the Official Sector Exclusion to the Membership Proposal appropriate in

light of the fact that foreign governments and central banks are significant participants in the market for U.S. Treasury securities, accounting for a significant portion of sales during the volatility in U.S. Treasury securities during March 2020?

• Do central banks, sovereign entities, or international financial institutions, as defined in Proposed Rule 17Ad–22(a), pose risks to their counterparties that could potentially be transmitted back to a U.S. Treasury securities CCA and on to the broader financial system? How could such risk be mitigated? Should the Commission condition the Official Sector Exclusion, as set forth in paragraph (iii) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a), on the exchange of margin, haircuts and/or other risk management measures?

• How would a U.S. Treasury securities CCA craft policies and procedures reasonably designed to permit it to identify (and therefore exclude its members') transactions subject to the Official Sector Exclusion?

• Should the Official Sector Exclusion to the Membership Proposal include state or local governments? Why or why not? If so, how should these entities be defined for this purpose? Do these entities use leverage or otherwise pose risk to a U.S. Treasury securities CCA that is more similar to the entities that are subject to the Membership Proposal? Are there other factors the Commission should consider in deciding whether to include state or local governments within the Official Sector Exclusion?

• Is the exclusion of transactions with natural persons from the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) appropriate? If natural persons are transacting repurchase or reverse repurchase transactions with direct participants of a U.S. Treasury securities CCA, is there any reason to exclude those transactions from the Membership Proposal? What proportion of the specified accounts in paragraph (iii)(C) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) would be subject to the natural person exclusion contemplated in Proposed Rule 17Ad–22(a)? Is the exclusion of those accounts appropriate?

• Should the exclusion of transactions with natural persons from the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) be conditioned on the exchange of margin, haircuts and/or other risk management measures? If so what measures would be appropriate for this exclusion?

• Should the natural person exclusion in paragraph (iii) of the definition of an ''eligible secondary market transaction'' in Proposed Rule 17Ad–22(a) be subject to a volume or size cap, a net worth threshold, or any other limitation? If so, how should such limitation be set?

• Should inter-affiliate transactions be excluded from the definition of an eligible secondary market transaction by adding an exclusion to the definition in Proposed Rule 17Ad–22(a) for all such transactions? Why or why not? How should exceptions be identified? Should the Commission condition this potential exclusion from the Membership Proposal for inter-affiliate transactions on the exchange of margin, haircuts and/or other risk management measures?

• Should any additional exclusion to the definition of an eligible secondary market transaction in Proposed Rule 17Ad–22(a) be limited to certain transaction volumes or account size thresholds or to particular counterparties? If so, how should these thresholds or counterparty levels be set? Should they be accompanied by a transition period when a previously exempted transaction becomes subject to the clearing requirement? Would a U.S. Treasury securities CCA be able to write policies and procedures that would be effective in accomplishing this task while still promoting central clearing of other U.S. Treasury securities transactions?

• Are there any legal, operational or other considerations that could impede an indirect participant's ability to participate indirectly as proposed under the Membership Proposal? Are there any particular changes to the Membership Proposal that could help facilitate their ability to participate as indirect participants? Should any other indirect participants or transactions be excluded from the Membership Proposal on the basis of any such legal, operational or other considerations?

• Are there other changes the Commission can make to the design of the Membership Proposal to improve the resiliency of and liquidity in the U.S. Treasury securities market?

• Do commenters agree with Proposed Rule 17Ad–22(e)(18)(iv)(B) that would require a U.S. Treasury securities CCA to have policies and procedures to identify and monitor its direct participants' submission of transactions for clearing as required in the Membership Proposal, including how the CCA would address a failure to submit transactions? Why or why not?

• What types of policies and procedures should a U.S. Treasury securities CCA implement to comply with the requirements of Proposed Rule 17Ad–22(e)(18)(iv)(B), if adopted? What level of detail and transparency would commenters find appropriate regarding such policies and procedures?

• Do commenters believe that a U.S. Treasury securities CCA could develop appropriate procedures to comply with the requirements of Proposed Rule 17Ad–22(e)(18)(iv)(B), if adopted?

• In the event that there were to be more than one U.S. Treasury securities CCA, should the Commission amend Rule 17Ad–22(e)(20) (17 CFR 240.17Ad–22(e)(20)) to require each such CCA to establish a link with each other Treasury CCA so that the direct participant of either Treasury CCA may satisfy the requirements of Proposed Rule 17Ad–22(e)(18)(iv) without becoming a direct participant of each Treasury CCA? Are there any other steps that the Commission should take?

• Will the Membership Proposal have any impact on competition in the provision of CCP services in the U.S. Treasury market? Will the Membership Proposal inappropriately concentrate risk in a single U.S. Treasury securities CCA?

B. Other Changes to Covered Clearing Agency Standards

As proposed, the Membership Proposal 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. For example, as noted above, approximately 68% of the overall dollar volume of cash market activity in the U.S. Treasury market is bilaterally cleared, and dealer-to-customer trading appears to comprise significant portion of that market.[196] Further, it appears that the customer side of this market is heterogeneous with diverse participants, including pension funds and asset managers who, as noted above, do not participate in central clearing to a great extent, especially for cash market transactions.[197]

The Commission believes that certain additional changes to its Covered Clearing Agency Standards that would apply only to U.S. Treasury securities CCAs are warranted in light of the Membership Proposal. Such changes, described further below, are designed to improve risk management by and access

[196] *See* note 20 *supra.*

[197] IAWG Report, *supra* note 4, at 3.

to the US Treasury securities CCA, and will also serve to help manage the risks and facilitate access that would likely result from the Membership Proposal. Thus, as part of ensuring its written policies and procedures are reasonably designed to ensure all of its direct participants clear all eligible secondary market transactions in U.S. Treasury securities, the Commission proposes to require that U.S. Treasury securities CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin for a direct participant's proprietary positions separately from the margin calculated and collected from that direct participant in connection with U.S. Treasury securities transactions by an indirect participant (customer) that relies on the services provided by the direct participant to access the U.S. Treasury securities CCA. This proposal would prohibit a U.S. Treasury securities CCA from netting customer and proprietary positions. In addition, the Commission proposes to require that U.S. Treasury securities CCAs establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, ensure that they have 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 reviews annually.[198]

To the extent that changes to the U.S. Treasury securities CCA's rules or procedures are necessary in light of these proposed amendments to the Covered Clearing Agency Standards, the U.S. Treasury securities CCA, as a self-regulatory organization, would be required file such changes for Commission review and approval, as appropriate, under section 19(b) of the Exchange Act.[199] In addition, if a U.S. Treasury securities CCA has been designated as a systemically important financial market utility, changes to programs allowing indirect participants to clear or changes to margin methodologies or practices may need to be filed as advance notices, to the extent that the changes materially impact the nature or level of risk presented by that covered clearing agency, which would therefore require consultation with the Federal Reserve Board of Governors as well.[200]

1. Netting and Margin Practices for House and Customer Accounts

The Commission believes that, in conjunction with the Membership Proposal, further proposed changes with respect to risk management requirements could also reduce the potential risk to the U.S. Treasury securities CCA arising from such transactions. As described more fully below, the Commission is proposing amendments to 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. 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, as discussed further below.

Currently, the Commission's rules do not address how a U.S. Treasury securities CCA should calculate, collect, and hold margin amounts for any U.S. Treasury securities transactions, cash or repo, that a direct participant may submit on behalf of an indirect participant. This means that a U.S. Treasury securities CCA generally may determine a participant's margin for both proprietary and client positions using the methodology that it determines to be appropriate, while still remaining responsible for complying more generally with the applicable margin requirements under Rule 17Ad–22(e)(6).[201]

For example, in practice, at what is currently the only U.S. Treasury securities CCA, 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. Transactions between direct participants are novated by the U.S. Treasury securities CCA, 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.[202] Under its current client clearing models (except the FICC sponsored member program),[203] for a dealer to client trade, although there is no transaction between two direct participants to novate, FICC novates the transaction and becomes a counterparty to the direct participant that has submitted that transaction, but does not have a direct relationship with the direct participant's client.[204] 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.[205]

Under the proposed amendments to Rule 17Ad–22(e)(6)(i), a U.S. Treasury securities CCA would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, calculate margin amounts for all transactions a direct participant submits to the CCP on behalf of others, separately from the margin that is calculated for transactions that the direct participant submits on its own

[198] For example, to the extent that the additional transactions may present different risks on an intraday basis, a U.S. Treasury securities CCA should consider its policies and procedures in light of that risk, especially with respect to policies and procedures designed to meet the requirements of Rules 17Ad–22(e)(6) and (7) (17 CFR 240.17Ad–22(e)(6) and (7)).

[199] *See* 78 U.S.C. 78s; 17 CFR 240.19b–4.

[200] *See* 12 U.S.C. 8465; 17 CFR 240.19b–4.

[201] Specifically, Rule 17Ad–22(e)(6) requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, cover its credit exposure to its participants by establishing a risk-based margin system that, at a minimum and among others: considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market; and 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. 17 CFR 240.17Ad–22(e)(6)(i and iii).

[202] *See* FICC PFMI Disclosure Framework at 10; FICC Rule 11, section 4.

[203] In FICC's sponsored member program, both the Sponsoring Member and the Sponsored Member are members of FICC, and FICC has certain obligations to both entities, including a guaranty of settlement to the Sponsored Member. *See generally* FICC Rule 3A; Depository Trust & Clearing Corporation, *Making the U.S. Treasury Market Safer for All Participants: How FICC's Open Access Model Promotes Central Clearing,* at 6 (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'').

[204] Marta Chaffee and Sam-Schulhofer-Wohl, *Is a Treasury Clearing Mandate the Path to Increased Central Clearing, Chicago Fed Insights,* at 2 (June 23, 2021), *available at https://www.chicagofed.org/publications/blogs/chicago-fed-insights/2021/treasury-clearing-mandate* (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'') (''Chicago Fed Insights'').

[205] DTCC October 2021 White Paper, *supra* note 203, at 5–6.

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. The Commission believes that the customer positions that would be separated from a direct participant's proprietary positions generally would arise in the dealer-to-customer market, in which a dealer transacts directly, as a principal, with its customer, as discussed in section II.A.1 *supra.* Finally, the CCP would 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.

The proposed amendments to Rule 17Ad–22(e)(6)(i) are designed to ensure that central clearing of U.S. Treasury securities transactions between direct participants and indirect participants of a covered clearing agency clearing U.S. Treasury securities would result in the risk management benefits described above in section III.A.3 *supra,* as well as to incentivize additional central clearing in the U.S. Treasury market. Specifically, the proposed amendments to Rule 17Ad–22(e)(6)(i) 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. Because the indirect participant's positions are no longer netted against the direct participant's positions prior to being submitted for central clearing, the indirect participant's positions would be subject to the covered clearing agency's risk management procedures, including collection of margin specific to those transactions.[206] This should, in turn, help avoid the risk of a disorderly default in the event of a direct participant default, in that the CCA would be responsible for the central liquidation of the defaulting participant's trades and would be able to have a more holistic view of the market than would be available for competing bilateral efforts to close out transactions with a defaulting entity. Moreover, the proposed amendments to Rule 17Ad–22 (e)(6)(i) should result in dealer-to-customer trades gaining more benefits from central clearing.

FICC, in its sponsored membership program, already calculates, collects, and holds margin amounts for its sponsoring members separately and independently from those members they sponsor. FICC's rules specifically provide for the collection of margin for sponsored member trades on a gross basis, *i.e.,* the total margin amount required for the separate omnibus account for client trades must be equal to the sum of the individual margin amounts that would be due if each customer were margined separately.[207] The proposed amendments to Rule 17Ad–22(e)(6)(i), however, 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.

In these respects, the proposed amendments to Rule 17Ad–22(e)(6)(i) would require policies and procedures that closely resemble the calculation, collection, and holding of margin for listed options. 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.[208] 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,[209] which is consistent with the practice at the clearing agency for listed options and the proposed amendments to Rule 17Ad–22(e)(6)(i).

The approach proposed here would also be similar to the requirements applicable to cleared swaps, in that it would require the separation of proprietary and customer funds and securities held at a U.S. Treasury securities CCA.[210] However, it would not require any particular method for how customer funds and securities are segregated, which differs from the requirements applicable to derivatives clearing organizations clearing swaps. Such entities are subject to what has been referred to as a legally segregated, operationally commingled (''LSOC'') approach.[211] 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).[212] In other words, the LSOC model mitigates ''fellow customer risk'' arising from the default of a customer within the omnibus account. 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.[213] When discussing that conclusion, the Commission also 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 protected under SIPA, which is not the case for futures and cleared swaps.[214]

By contrast to the rules for margin for futures and cleared swaps, the proposed amendments to Rule 17Ad–22(e)(6)(i) would not require that a CCP clearing and settling transactions in U.S.

[206] The proposed amendments to Rule 17Ad–22(e)(6)(i) would not require that a U.S. Treasury securities CCA collect margin from indirect participants, but rather would ensure that U.S. Treasury securities CCAs determine margin for transactions submitted on behalf of indirect participants separately from those of direct participants.

[207] *See* FICC Rules 1 (definition of Sponsoring Member Omnibus Account) and 3A, section 10, *supra* note 47; DTCC October 2021 White Paper, *supra* note 203, at 6. Although not required under the proposed amendments to Rule 17Ad-22(e)(6)(i), calculation of gross margin for each customer, *i.e.,* the sum of the individual margin amounts that would be due if each customer were margined separately, as FICC does for the Sponsored Service, would be permissible under the proposed amendment.

[208] *See* Options Clearing Corp. Rule 601(c)–(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).

[209] *See* CCA Standards Proposing Release, *supra* note 7, 79 FR at 29547; CCA Standards Adopting Release, *supra* note 25, 81 FR at 70832–33.

[210] *See* 7 U.S.C. 6d(f)(2).

[211] 17 CFR 22.15.

[212] *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).

[213] *See* CCA Standards Adopting Release, *supra* note 25, 81 FR at 70832.

[214] *Id.* at 70833 (citing 15 U.S.C. 78eee *et seq.*).

Treasury securities calculate and collect margin for each customer on a gross basis.[215] Instead, the CCP would have the discretion to collect a single netted amount for each clearing member's customer account as a whole, *i.e.,* netting each customer's margin against that of other customers within the overall customer account. This is generally how margin is collected for listed options,[216] where, as noted above, SIPA acts to protect customer securities and funds at a participant broker-dealer.[217] However, in order for a registered broker-dealer to take advantage of the proposed debit in proposed item 15 of 17 CFR 240.15c–3–3a, if adopted, a U.S. Treasury securities CCA must collect margin on a gross basis, as discussed in section III.C *infra.*

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

The Commission understands that the various models currently available to access central clearing in the U.S. Treasury market may not meet the needs of the many different types of market participants who transact in U.S. Treasury securities with the direct participants of a U.S. Treasury Securities CCA. Although some market participants may choose to become a member of a U.S. Treasury securities CCA, this approach likely would not be viable for a broad range of participants in the U.S. Treasury market for legal, operational and other reasons. Currently, there are several methods available to allow market participants to access CCP services through a FICC member.[218] However, based on its supervisory experience, the Commission understands that these models may not meet the regulatory or business needs of all market participants, including indirect participants whose transactions with direct participants would likely be encompassed by rules that FICC would impose, as required by the Membership Proposal if adopted, that its direct participants submit for clearance and settlement all eligible secondary market transactions in U.S. Treasury securities. Consequently, the Commission believes that the access models used at a U.S. Treasury securities CCA will need to be revisited to help ensure that more transactions by indirect participants (particularly in the dealer-to-customer market) could be submitted to comply with the Membership Proposal, if adopted.

With regard to methods of access, the Commission understands 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. For example, certain market participants may tend to prefer to bundle trading and execution services with a single entity that is a U.S. Treasury securities CCA member for regulatory, operational, and other reasons.[219] By contrast, other market participants would prefer to be able to utilize clearing services unbundled from execution services from U.S. Treasury securities CCA members and would prefer that such members operate their clearing services independently from execution services, as appears common in other asset classes.[220] In addition, some market participants have expressed concerns with the way FICC's direct participants conduct their business regarding access for indirect participants, specifically, that FICC direct participants sponsoring indirect members are not willing to submit transactions for such indirect participants to which the direct participant is not a party (*i.e.,* ''done away'' transactions).[221] These concerns, however, are based on the business decisions of FICC's direct participants rather than the operation of FICC's Rules; although FICC does not restrict its Sponsoring Members' ability to be both a trading counterparty and submitting clearing member for an indirect participant, FICC's Rules allow direct participants in its sponsored membership program to submit ''done away'' transactions, if they so choose. Accordingly, as currently constituted, FICC's rules permit but do not require that its direct participants accept such transactions.[222]

The Commission is proposing Rule 17Ad–22(e)(18)(iv)(C) to 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. Although this new provision would not prescribe specific methods for market participants to obtain indirect access to a U.S. Treasury securities CCA, it 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.

This new proposed requirement would further expand current Rule 17Ad–22(e)(18), which requires that a covered clearing agency 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 permit fair and open access by direct and, where relevant indirect participants. Because the Membership Proposal likely would require direct participants to submit additional eligible secondary market transactions for clearing, thereby raising the need for the direct participants to centrally clear transactions with indirect participants that are not currently submitted for clearing, the Commission believes that expanding Rule 17Ad–22(e)(18) to provide additional requirements regarding a U.S. Treasury securities CCA's consideration of whether it has ensured appropriate access for indirect participants should help facilitate adoption and implementation of the Membership Proposal, as it will provide additional or reworked models which direct participants can use to submit their transactions executed on behalf of or with indirect participants for central clearing, and lead to better risk management of the risks posed by indirect participants to a U.S. Treasury securities CCA.

To facilitate compliance with this proposed requirement, the Commission believes that a U.S. Treasury securities CCA generally should conduct an initial

[215] *See* 17 CFR 39.13(g)(8)(A and C) (requiring the collection of initial margin for each customer account equal to the sum of the initial margin accounts that would be required if the individual customer were a direct participant and prohibiting a derivatives clearing organization from netting, or permitting its clearing members to, net positions of different customers against one another).

[216] *See* OCC Rule 810(a)–(c), *supra* note 208.

[217] *See supra* note 210.

[218] *See, e.g.,* FICC Rules 3A, 8, 18, *supra* note 47 (providing for prime brokerage and correspondent clearing and sponsored membership); *see also* October 2021 White Paper, *supra* note 198, at 5–7.

[219] DTCC October 2021 White Paper, *supra* note 203, at 5, 7.

[220] Futures Industry Association Principal Traders Group, *Clearing a Path to a More Resilient Treasury Market,* at 10 (Jul. 2021), *available at https://www.fia.org/sites/default/files/2021-07/FIA-PTG_Paper_Resilient%20Treasury%20Market_FINAL.pdf* (''FIA PTG Whitepaper'').

[221] *Id.* at 7–9.

[222] *See* DTCC October White Paper, *supra* note 203, at 6–7; Exchange Act Release No. 85470 (Mar. 29, 2019), *supra* note 126 (approving changes to FICC's Rules to allow Sponsored Members to transact with FICC members that are not their Sponsoring Member).

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. The Commission believes 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. 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)(B).

The Commission believes that a U.S. Treasury securities CCA generally should review 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 who 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)(B) generally should include consideration 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, a U.S. Treasury securities CCA generally should consider whether to include in its policies and procedures non-discrimination principles, similar to those the CFTC promulgated to foster the clearance and settlement of swaps,[223] to the extent that they are applicable to the clearance and settlement of U.S. Treasury securities. Taken together, initiatives such as these, along with others identified by a U.S. Treasury securities CCA through consultations with relevant stakeholders—including indirect participants—should help ensure that a U.S. Treasury securities CCA is offering appropriate means to facilitate access to its clearance and settlement services for U.S. Treasury securities. 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.[224]

Further, as noted above, the Commission is proposing to require annual review by the CCA's board of directors of the CCA's written policies and procedures designed 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. The Commission believes that such requirement is important to ensure that such policies regarding access to clearance and settlement services, including for indirect participants, are addressed at the most senior levels of the governance framework of the covered clearing agency, consistent with the importance of such requirements. The review by a U.S. Treasury securities CCA's board of directors under proposed Rule 17Ad–22(e)(18)(iv)(B) 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.

3. Request for Comment

The Commission generally requests comments on all aspects of new proposed Rules 17Ad–22(e)(6)(i) and 17Ad–22(e)(18)(iv)(C). In addition, the Commission requests comments on the following specific issues, with accompanying data and analysis:

- Do commenters agree or disagree with any particular aspects of proposed Rule 17Ad–22(e)(6)(i)? If so, which ones and why? If commenters disagree with any provision of the proposed rule, how should such provision be modified and why?
- Do commenters agree that the transactions in a direct participant's customer account would generally consist of its transactions in the dealer-to-customer market, as a principal to transactions with its customers? Should the Commission further define or distinguish between proprietary and customer positions in the proposed rule text?
- As discussed above, the proposed amendments to Rule 17Ad–22(e)(6)(i) do not require a particular approach to the methodology used for calculating customer margin, that is, whether customer margin should be determined on a gross or net basis, by contrast to the gross margin requirement for customer margin for futures and cleared swaps.[225] Should the Commission consider further amendments to Rule 17Ad–22(e)(6) or other Commission rules to include such a requirement? If so, how would such a requirement interact with SIPA [226] and the Bankruptcy Code [227] in the event of a broker-dealer default?
- Do commenters believe that additional requirements with respect to the collection of margin at the customer level, *i.e.,* further segregation of customer margin within a customer account (such as an LSOC model) would bring particular costs or benefits to the market? How would any such additional requirement interact with SIPA and the Bankruptcy Code in the event of a broker-dealer default?
- More generally, what impact would the proposed amendment to Rule 17Ad–22(e)(6)(i)(A) have on bankruptcy issues arising under SIPA? Would additional SIPA or bankruptcy issues arise in the event of additional margin requirements similar to those for futures and/or cleared swaps?
- Would the proposed amendment to Rule 17Ad–22(e)(6)(i) potentially support (or not support) the expanded use of cross-margining agreements?
- Do commenters believe that the proposed amendment to Rule 17Ad–22(e)(6)(i) would increase (or decrease) the amount of margin required to be collected from direct participants of a U.S. Treasury securities CCA?
- Do commenters agree that the requirement to separately calculate, collect, and hold customer margin would further incentivize central clearing in the U.S. Treasury market?
- Do commenters agree or disagree with any particular aspects of proposed Rule 17Ad–22(e)(18)(iv)(C)? If so, which

[223] *See* 17 CFR 39.12(a)(1)(vi).

[224] *See* 15 U.S.C. 78s(b); 17 CFR 240.19b–4; 12 U.S.C. 5465(e).

[225] *See* 17 CFR 39.13(g).

[226] *See* 15 U.S.C. 78aaa *et seq.*

[227] *See* 11 U.S.C. 1 *et seq.*

ones and why? If commenters disagree with any provision of the proposed rule, how should such provision be modified and why?

• Do commenters agree that proposed Rule 17Ad–22(e)(18)(iv)(C) is sufficient to facilitate access to the clearance and settlement services of a U.S. Treasury securities CCA for both direct and indirect participants?

• Do commenters agree that certain market participants may not be able to satisfy a covered clearing agency's membership criteria? If so, which particular entities, and what are the reasons?

• In addition, do commenters agree that particular legal, operational or other considerations may further preclude many market participants from becoming direct members of a U.S. Treasury securities CCA? If so, which entities, and why? For example, are there particular requirements under the Investment Company Act of 1940 or Investment Advisers Act of 1940 that may preclude particular registered funds or their sponsors from participating as direct clearing members?

• Among market participants that cannot become direct members of a U.S. Treasury securities CCA, are there particular entities that may be further precluded from participating as indirect participants? If so, which entities, and what might be some of the legal, operational or other considerations that may preclude them from becoming indirect participation?

• Are there specific changes to the current indirect participation models that could help facilitate participation by certain market participants? In addition, are there specific changes to particular Commission rules that could facilitate further participation of indirect participants?

• Would a separation between trade execution and clearing services at broker-dealers pose issues for any of the market participants in the market for U.S. Treasury securities?

• Would a separation between trade execution and clearing services at broker-dealers lead to regulatory arbitrage in view of the fact that the Commission generally does not regulate banks that are not otherwise registered with the Commission?

• Should the Commission amend the Covered Clearing Agency standards to require that a U.S. Treasury securities CCA, in turn, require its direct participants to clear transactions executed between indirect participants but submitted to a direct participant for clearing? How effective is such a rule likely to be in view of the restriction in Exchange Act section 17A(b)(3)(E),[228] which prohibits any clearing agency from imposing any schedule of prices, or fixing rates or other fees, for services rendered by its participants?

C. Proposed Amendments to Rule15c3–3a

1. Proposal

The proposed rules 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 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 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 Membership Proposal would result in corresponding increases in the need to use broker-dealers' cash and securities to meet these requirements.

To facilitate implementation of the Membership Proposal, the Commission is proposing 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 new debit item would be reported on a newly created Item 15 of the Rule 15c3–3a reserve formula. The proposed amendments also would 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 are designed to permit the inclusion of the debit only under conditions that would provide maximum protection to the broker-dealer's customers. The goal is 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.

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 are based, in part, on the conditions in Note G and the requirements in 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 are designed to permit the debit under circumstances that provide protection to customers.

Under the proposed amendments, current Item 15 of the Rule 15c3–3a formula would be renumbered Item 16.[229] Proposed 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''). As proposed, this debit item would be 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 this proposal. Further, this debit item would be limited to customer position margin required and on deposit at the U.S. Treasury securities CCA as a result of 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.[230] Finally, the debit would be limited to customer position margin *required* and on deposit at the

[228] 15 U.S.C. 78q–1(b)(3)(E).

[229] Current Item 15 is where the broker-dealer reflects the amount, if any, that total credits exceed total debits.

[230] As discussed above in section II.B.2., debit items offset credit items thereby reducing the amount of cash or qualified securities that need to be held in the customer reserve account to cover the broker-dealer's cash liabilities to its customers.

U.S. Treasury securities CCA. This would mean that the broker-dealer could not include in 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.

As proposed, Item 15 of the Rule 15c3–3a formula would have a Note H that sets forth a number of 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. 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 on deposit at the U.S. Treasury securities CCA.

The first condition would be set forth in Note H(a), which would provide 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. Treasury securities CCA. The objective is 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).[231] As discussed above, the liquidity of the debit items protects the customers whose cash or securities are used to finance or facilitate customer transactions.

Proposed Note H(b) to Item 15 would set forth three 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. The first condition set forth in Note H(b)(1) would provide 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 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.[232] 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 this condition—the need to use customer assets exclusively—is to segregate the customer assets being used to meet the customer position margin requirement from the broker-dealer's proprietary assets. Additional conditions would provide 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. The first prong of the condition is designed to ensure that only customer assets are held in the account.

The objective of the second component of this 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—is to avoid the use of one customer's assets to meet another customer's margin requirement. 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 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.[233] 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 first 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 first condition—that the broker-dealer had delivered the customer's assets to the U.S. Treasury securities CCA—is to address the potential that a customer may use more than one broker-dealer to engage in U.S. Treasury securities transactions. 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 U.S. Treasury securities positions. The intent is 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

[231] *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).

[232] Cash owed by a broker-dealer to customers is a credit item that is included in Item 1 to the Rule 15c3–1a formula. Thus, cash owed to customers that is used to meet a customer position margin requirement will be accounted for as a credit in Item 1. 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. *See* Items 2 and 3 to Rule 15c3–3a. The credit items are designed to require the broker-dealer to reserve sufficient funds to be able to retrieve securities collateralizing the borrowed funds or that 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' U.S. Treasury securities to meet a customer position margin requirement. Consequently, the Commission is proposing to amend Note B to Item 2 of the Rule 15c3–1a 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.

[233] *See* note 207 *supra.*

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 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.

Proposed Note H(b)(2) to Item 15 would set forth the second condition for including customer position margin as a debit in the Rule 15c3–3a formula. Under this condition, the customer position margin would need to 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).

Proposed Note H(b)(2)(i) to Item 15 would provide that the customer position margin is 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. As discussed above, a component of the condition in proposed Note H(b)(1) is 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. Treasury securities positions. This condition in proposed Note H(b)(2) is designed to facilitate that condition in proposed Note H(b)(1) by requiring that the U.S. Treasury securities CCA has rules to perform separate customer position margin calculations for each customer of the broker-dealer. 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 condition would provide that the U.S. Treasury securities CCA has rules requiring the broker-dealer to deliver the 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.

Proposed Note H(b)(2)(ii) to Item 15 would provide that the customer position margin is 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 less. As discussed above, proposed Note H(a) would provide that the collateral delivered to the U.S. Treasury securities CCA by the broker-dealer to meet the customer position margin requirement must be in the form of cash or U.S. Treasury securities. The objective is to limit the assets underlying the debit item to the safest and most liquid instruments. This objective would be undermined if the U.S. Treasury securities CCA could invest the cash delivered by the broker-dealer or cash obtained by using the U.S Treasury securities delivered by the broker-dealer in assets other than cash and U.S. Treasury securities. Moreover, while the broker-dealer could deliver customer U.S. Treasury securities with a maturity greater than one year, the U.S. Treasury securities CCA's rule would need to limit it to investing customer position margin in U.S. Treasury securities with a maturity of one year or less. The object is to limit the investments to the safest most liquid instruments.

Proposed Note H(b)(2)(iii) to Item 15 would provide that the customer position margin is 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 margin and set strict limitations on the U.S. Treasury securities CCA's ability to use the margin. The required rules are modeled on the requirements for a broker-dealer to include a debit with respect to margin delivered to a security-based swap CCA.[234] In particular, the note would provide that the customer position margin is 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 or 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 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 is 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. Further, the account designation and written notice requirements are 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 is 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 the loss.

[234] *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). *See also* 84 FR at 43938–42, *supra* note 99.

Proposed Note H(b)(2)(iv) to Item 15 would provide that the customer position margin is treated in accordance with rules designed to address how the U.S. Treasury securities CCA holds the customer position margin. Similar to proposed Note H(b)(2)(iii) to Item 15, the objective would be 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 would provide that the customer position margin is 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 is 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;
- 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.[235]

Proposed Note H(b)(2)(v) to Item 15 would provide 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 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 after the day the customer position margin is no longer needed for this purpose. 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 is to effectuate the prompt return of customer position margin to the broker-dealer.

Proposed Note H(b)(3) to Item 15 would set forth the third condition for including customer position margin as a debit in the Rule 15c3–3a formula. 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 to Item 15. If satisfied with the staff's recommendation, the Commission would publish a positive notice. The objective is to permit the debit only after the Commission has approved the U.S. Treasury securities CCA's rules pursuant to section 19(b) of the Exchange and published the notice.[236] 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.

Finally, broker-dealers are required to perform a separate reserve computation for their broker-dealer customers and maintain a separate reserve account with respect to that computation.[237] 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.[238] Therefore, the proposed amendments discussed above adding a new debit in Item 15 would apply to the PAB reserve computation. Further, the Commission is proposing 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 apply to the PAB reserve computation as well.

2. Request for Comment

The Commission generally requests comments on all aspects of the proposed amendment to Rule 15c3–3a. In addition, the Commission requests comments on the following specific issues, with accompanying data and analysis:

- Do commenters agree or disagree with any particular aspects of the proposed amendment to Rule 15c3–3? If so, which ones and why? If commenters disagree with any provision of the proposed rule amendment, how should such provision be modified and why?
- Rule 15c3–3 defines the term ''excess margin securities'' to mean those securities referred to in paragraph

[235] *See, e.g.,* 17 CFR 240.15c3–3a, Note G(b)(2) to Item 14 (setting forth similar requirements when a securities futures clearing agency holds customer margin at a bank).

[236] *See* 15 U.S.C. 78s.

[237] *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).

[238] *See* 17 CFR 240.15c3–3a, Notes 1 through 10 Regarding the PAB Reserve Bank Account Computation.

(a)(4) of Rule 15c3–3 carried for the account of a customer having a market value in excess of 140 percent of the total of the debit balances in the customer's account or accounts encompassed by paragraph (a)(4) of Rule 15c3–3 which the broker-dealer identifies as not constituting margin securities. With respect to cleared, settled, and novated repurchase and reverse purchase agreements in U.S. Treasury securities, how should this 140 percent test be applied?

• In terms of protecting customer position margin held at the U.S. Treasury securities CCA, should the Commission adopt other clearing models? For example, should the Commission adopt an approach similar to how margin for swaps cleared at a U.S. derivatives clearing organization is treated? If so, explain how such a model would work in a liquidation of the broker-dealer under SIPA.

• Are there any legal or operational issues that particular participants may face as a result of customer position margin held by a U.S. Treasury securities CCA? Do commenters believe there may be the need for other regulatory relief or guidance by the Commission or other regulators to facilitate the holding of such customer margin? Are there any particular entities that should be exempted from the margin requirements due to particular legal, operational or other issues?

• Should the Commission adopt further measures to protect the customer cash and U.S. Treasury securities that are used to meet the customer position margin requirements of the U.S. Treasury securities CCA? For example, should the Commission adopt measures to protect the cash and U.S. Treasury securities in the event of an insolvency of the U.S. Treasury securities CCA? In this regard, should the Commission require that the cash and U.S. Treasury securities be held at a third-party bank in an account that is subject to an agreement between the U.S. Treasury securities CCA, the broker-dealer, and the bank that the assets in the account may only be accessed by the U.S. Treasury securities CCA to cover a loss resulting from a customer of the broker-dealer failing to meet an obligation to the U.S. Treasury securities CCA? Would this approach be workable or practical? Please explain.

D. Compliance Date

The Commission understands that an existing U.S. Treasury securities CCA likely would need time and resources to develop and adopt policies and procedures to implement the standards set forth in this proposal, if adopted, for its business. In addition, as noted above, any changes to a U.S. Treasury securities CCA's rules would require that the CCA file proposed rule changes under section 19(b) of the Exchange Act and/or section 806 of the Dodd-Frank Act, as applicable, for the Commission to review and consider such changes for consistency with the applicable standards. More generally, the Commission recognizes that the changes set forth in this proposal, if adopted, including the likely substantial amount of additional transactions to be submitted for central clearing that are not currently submitted in large volumes (such as the dealer-to-customer market) would represent a significant change in current industry practice that may take time for market participants to navigate.

The Commission is not proposing a specific compliance date at this time, but instead seeks comment regarding what would be an appropriate timeframe.

The Commission generally solicits comment on what an appropriate compliance date would be for each of the proposed rule amendments (Rule 17Ad–22(e)(18), Rule 17Ad–22(e)(6)) if adopted. In addition, the Commission requests comments on the following specific issues, with accompanying data and analysis:

• How long would U.S. Treasury securities CCAs and market participants need to implement the proposal if it is adopted substantially as proposed? What data points would U.S. Treasury securities CCAs and market participants use to assess the timing? Are any specific operational or technological issues raised that should be factored into a proposed compliance date?

• Would staggering the compliance dates for the different rule amendments proposed help facilitate an orderly implementation of the proposal, if adopted? For example, would it be appropriate for the compliance date for paragraphs (ii)(A) and (B) in the definition of an ''eligible secondary market transaction'' to be before the compliance date for paragraphs (ii)(C) and (D) of the same definition, and if so, how much before? More generally, if staggering is appropriate, what would be an appropriate schedule of compliance dates?

IV. Economic Analysis

The Commission is mindful of the economic effects that may result from the proposed 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.[239] 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.[240] This section analyzes the expected economic effects of the proposed rules relative to the current baseline, which consists of the current market and regulatory framework in existence today.

In this proposal, the Commission is proposing additional requirements for any U.S. Treasury securities CCA.[241] First, the proposal would require that such CCAs establish 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 CCA submit for clearance and settlement all eligible secondary market transactions to which they are a counterparty (''Membership Proposal'').[242] In addition, the proposal would require that such CCAs establish 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, address a failure to submit transactions. The Commission believes that 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.[243]

Second, the Commission is proposing 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

[239] *See* 15 U.S.C. 78c(f).

[240] *See* 15 U.S.C. 78w(a)(2).

[241] *See supra* section III.A.

[242] *See supra* section III.A for a description of the Membership Proposal including the definition of ''eligible secondary market transaction.''

[243] *See infra* section IV.B.6.

access the CCA's services.[244] As discussed in more detail below, the Commission believes that 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 proposing requirements 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 the board of directors reviews these policies and procedures annually.[245] Although the proposed requirements would not prescribe specific methods for market participants to obtain indirect access to a U.S. Treasury securities CCA, it 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.

Lastly, the Commission is proposing to amend 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.[246] As discussed further below, the Commission believes that this proposal, in conjunction with the proposal requiring the separation of house and customer margin, will incentivize and facilitate additional central clearing in the U.S. Treasury securities market.

The discussion of the economic effects of the proposed rule 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 proposal, as well as its effects on efficiency, competition, and capital formation. The Commission has, where practicable, attempted to quantify the economic effects expected to result from this proposal. In some cases, however, data needed to quantify these economic effects is not currently available or otherwise publicly available. For example, the reporting of data for bilaterally-cleared repo transactions is currently not a regulatory requirement, so counterparty-specific statistics are not available and any aggregate statistics on this market segment may not be comprehensive.[247] Likewise, the reporting of U.S. Treasury securities transactions to FINRA TRACE has been until recently[248] 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 these economic effects and solicits comment, including estimates and data from interested parties, that could help inform the estimates of the economic effects of the proposal.

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.[249] The purpose of posting collateral in financial transactions is to alleviate frictions caused by adverse selection and moral hazard.[250] 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 particular, 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.[251] A simple example 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 would mean 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.[252] 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.[253] 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

[244] *See supra* section III.B.1.

[245] *See supra* section III.B.2.

[246] *See supra* section III.C.

[247] Samuel J. Hempel, R. Jay Kahn, Vy Nguyen, & Sharon Y. Ross, *Non-centrally Cleared Bilateral Repo* (Aug 24, 2022), *available at: https://www.financialresearch.gov/the-ofr-blog/2022/08/24/non-centrally-cleared-bilateral-repo/.*

[248] Reporting of additional cash transactions to TRACE, by certain U.S. and foreign banks, began on September 1, 2022 but the recent nature of that change precludes the Commission from doing any analysis on that new reporting universe. *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), *available at https://www.govinfo.gov/content/pkg/FR-2021-10-28/pdf/2021-23432.pdf; see also* Supporting Statement for the Treasury Securities and Agency Debt and Mortgage-Backed Securities Reporting Requirements, *available at https://www.federalreserve.gov/reportforms/formsreview/FR%202956%20OMB%20SS.pdf.*

[249] An alternative method of reducing counterparty credit risk used in the securities industry 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.

[250] 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 Vuillemey, *The Economics of Central Clearing,* 13 Ann. Rev. Fin. Econ. 153, 158 (2021).

[251] 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.

[252] This example is from Duffie, *supra* note 186.

[253] *See* Gary Gorton & George Pennacchi, *Financial Intermediaries and Liquidity Creation,* 45 J. Fin. 49 (1990), *available at https://www.jstor.org/stable/2328809. See also* Francesca Carapella & David Mills, *Information Insensitive Securities: the Benefits of Central Counterparties,* Working Paper (2012), *available at https://www.newyorkfed.org/medialibrary/media/research/conference/2012/MP_Workshop/Carapella_Mills_information_insensitive_securities.pdf.*

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, 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, eliminating counterparty risk makes the security a more standard product. Standardization itself increases liquidity.[254]

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.[255]

Another potential benefit of central clearing is that 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 the liquidation of assets may mitigate suboptimal outcomes in the face of capital or margin constraints. For example, if investors believe that 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 participants can commit to not sell, then a more efficient equilibrium in which there is no fire sale could be achieved. In this way, the CCP acts as a way to select into the more efficient equilibrium by allow members to credibly pre-commit to the auction in the case of a missed margin call.[256]

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.[257] The reason is that novation of the trade to a central counterparty reduces one of the major reasons for not choosing a counterparty: the risk 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,[258] 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 of the 2008 financial crisis emphasize the role of intermediary balance sheet constraints as a cause of financial crises.[259] [260] 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 replace them in order to provide liquidity.[261] 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.[262] [263]

B. Baseline

1. U.S. Treasury Securities

As discussed in section II.A, 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.[264] A number of types of market participants intermediate between end users of U.S. Treasury securities. These end users may 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

[254] *See* Ben Bernanke, *Clearing and Settlement During the Crash,* 3 Rev. Fin. Stud. 133 (1990), *available at http://www.bu.edu/econ/files/2012/01/Bernanke-RFS.pdf.*

[255] Dietrich Domanski, Leonardo Gambacorta, & Cristina Picillo, *Central Clearing: Trends and Current Issues,* BIS Q. Rev. (Dec. 2015), *available at https://www.bis.org/publ/qtrpdf/r_qt1512g.pdf.*

[256] John Kuong, *Self-fulfilling Fire Sales: Fragility of Collateralized Short-term Debt Markets,* 34(6) Review of Financial Studies, 2910–2948 (2021), *available at https://academic.oup.com/rfs/article/34/6/2910/5918033?login=true.*

[257] G–30 Report, *supra* note 5, at 13.

[258] *See* TMPG White Paper, *supra* note 20, (''[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 of the Federal Reserve System. *See supra* note 17 and associated text.

[259] *See, e.g.,* Markus K. Brunnermeier & Yuliy Sannikov, *A Macroeconomic Model with a Financial Sector,* 104 Am. Econ. Rev. 379 (Feb. 2014), *available at https://www.aeaweb.org/articles?id=10.1257/aer.104.2.379; See also* Zhiguo He & Arvind Krishnamurthy, *Intermediary Asset Pricing,* 103 Am. Eco. Rev. 732 (Apr. 2013), *available at https://www.aeaweb.org/articles?id=10.1257/aer.103.2.732.*

[260] Balance sheet constraints and the impact of losses on risk aversion both apply to liquidity providers, or rather the ability and willingness of market participants to provide liquidity. This does not apply to the CCP as it does not supply liquidity.

[261] *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), *available at https://www.journals.uchicago.edu/doi/abs/10.1086/250059.*

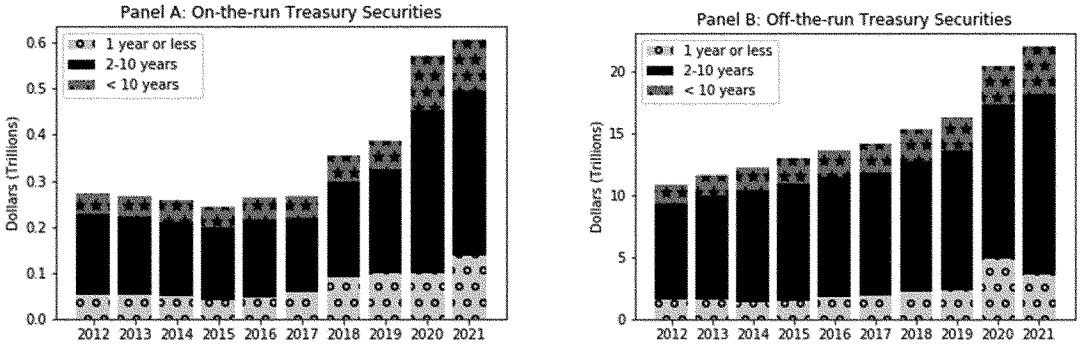
[262] G–30 Report, *supra* note 5, at 13. *See also* Duffie, *supra* note 186, at 4 (''Further, given broad access to a CCP, some Treasury transactions could flow directly from ultimate sellers to ultimate buyers without necessarily impinging on dealer balance sheet space.'').

[263] 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.

[264] 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 percent of the $651 billion traded daily across all Treasury securities.'' Fleming, Shachar, and Van Tassel, *supra* note 38. As discussed in section III.A.2, *supra,* for purposes of this Proposal 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. *Id.* (''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 in Economics and Finance 1 (2005), *available at https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci11-2.html.*

referred to as ''off-the-run''.[265] Figure 1 shows the outstanding value of on-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 2012–2021 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.

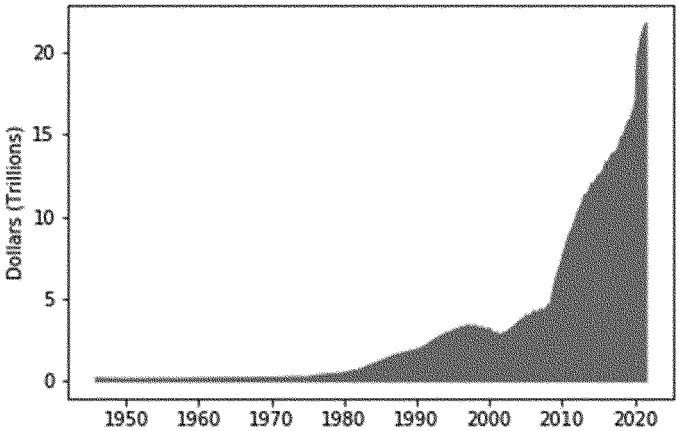
Figure 1: On-the-run and off-the-run U.S. Treasury securities (trillions) [a]



[a] Generated from the Federal Reserve Z1 Financial Accounts of the United States Table L.210 Treasury Securities, Series FL313161205.Q.

As of June 30, 2022, the total amount outstanding of marketable U.S. Treasury securities held by the public was $23.3 trillion.[266] As shown in Figure 2, the volume of marketable U.S. Treasury securities outstanding has increased by approximately $18 trillion since 2000. The total amount of marketable U.S. Treasury securities issued during 2021 was $20.3 trillion.[267]

Figure 2: Value of Marketable U.S. Treasury Securities Outstanding Over Time [a]



[a] Generated from the Federal Reserve Z1 Financial Accounts of the United States Table L.210 Treasury Securities, Series FL313161205.Q.

Trading in the secondary market is reported in Figure 3. According to industry reports, 65% of the $955.2 billion in average daily trading volume of U.S. fixed income securities in 2021 was in U.S. Treasury securities.[268] As is shown in Figure 3, average weekly trading volume was approximately $3 trillion in 2021, with notable peaks in March 2020 and early 2021.[269]

Figure 3: Weekly trading volume in U.S. Treasury securities cash market [a]

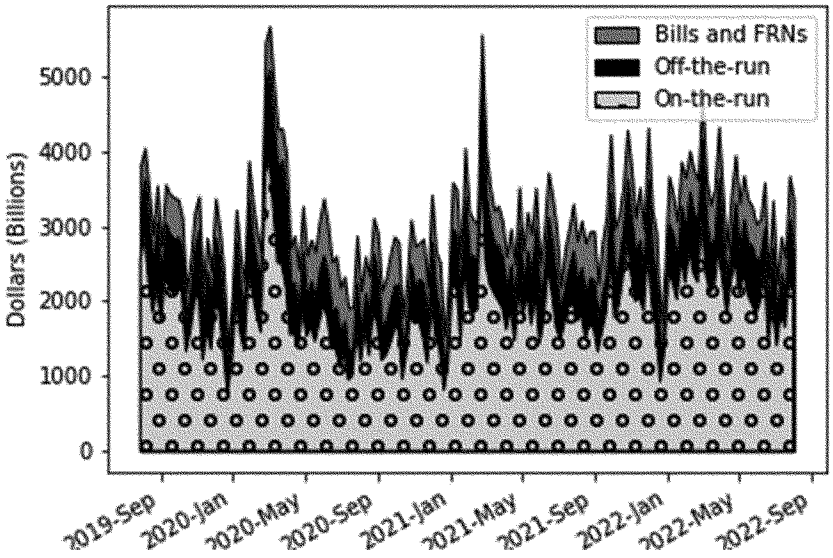
[265] *See supra* note 34.

[266] This includes $3.5T in bills, $13.6T in notes, $3.8T in bonds, 1.8T in TIPs, and 0.6T in floating rate notes. *See* U.S. Treasury Bureau of the Fiscal Service, *Summary of Treasury Securities Outstanding, available at https://fiscaldata.treasury.gov/datasets/monthly-statement-public-debt/summary-of-treasury-securities-outstanding.*

[267] *See* U.S. Treasury Bureau of the Fiscal Service, *Treasury Debt Position and Activity Report,* June 2022, *available at https://www.treasurydirect.gov/govt/reports/pd/pd_debtposactrpt_202206.pdf.*

[268] Another 29 percent was Agency MBS, 4 percent corporate debt, with the remainder in municipal, non-agency mortgage-backed, Federal agency debt and asset-backed securities. *See* Securities Industry and Financial Markets Association (''SIFMA''), *US Fixed Income Securities: Issuance, Trading Volume, Outstanding, available at https://www.sifma.org/resources/research/us-fixed-income-securities-statistics/us-fixed-income-securities-statistics-sifma/*(as of July 8, 2022) (data sourced from N.Y. Fed, FINRA TRACE, and MSRB).

[269] *Id.*



[a] *See* IAWG Report, *supra* note 4, at 14.

2. U.S. Treasury Repurchase Transactions

As described in section II.A.2 *supra,* 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, along with a commitment to repurchase the security at a specified price on a specified later date. 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 close equivalent to a cash loan with securities as collateral. The amount paid for the security serving as collateral may be less than the market price. The difference divided by the market value 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 lends to another against a class, not a specific issue, of U.S. Treasury securities. U.S. Treasury repo for a specific asset is generally a bilateral arrangement, whereas general collateral repurchases are usually arranged with a third agent, known as a triparty agent. In bilateral repo arrangements, the lender has the title of the specific asset in question, and can sell or re-hypothecate it. In triparty repo, which is discussed below, the lender has a more limited use of collateral. However, it is often re-hypothecated within the same triparty system; namely, a lender may use the collateral from the borrower for its own borrowing.

As described in section II.A.2 *supra,* repurchase agreements are generally classified by the term over which they take place, either ''overnight'' or ''term.'' 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.[270]

U.S. Treasury repo has various economic uses. First, it is a means of 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 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.[271]

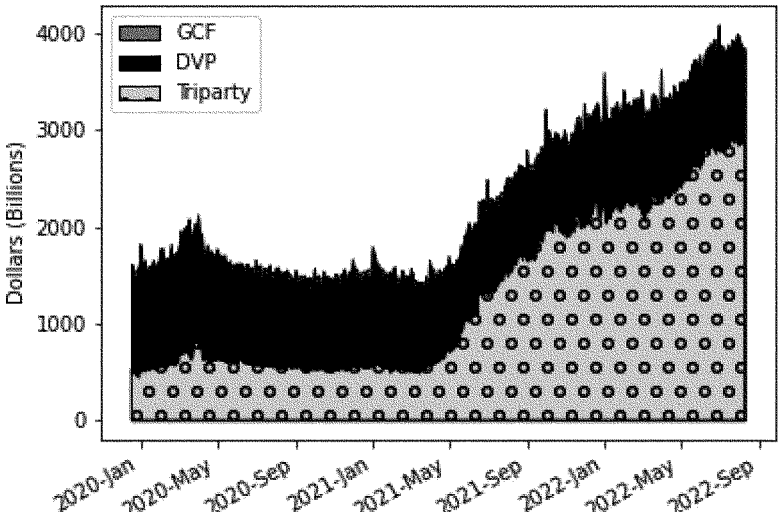
The market for repos is dominated by large sophisticated institutions. The institutions that participate in the market for repos are also those for whom access to central clearing may be the least costly economically. Relatedly, although difficult to quantify precisely, the number of participants is one or more orders of magnitude greater in the cash market as compared with the repo market: tens of thousands as opposed to hundreds. As Figure 4 shows, the U.S. Treasury securities repurchase market is large; throughout 2020 and into 2021, daily transaction volume ranged between $1.5 and $2.5 trillion per day. Since April 2021, average daily volume has been considerably higher—approaching $4 trillion per day—coinciding with the growth in the Federal Reserve's overnight reverse repurchase operations. Figure 4 further splits these categories out into triparty repo and bilateral repo. 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 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

[270] 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 repos 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 their discretion. ''Open'' repos have no defined term but rather allow either party to close out at the contract at any date after initiation of the agreement.

[271] *See supra* note 164.

approximately half of all bilateral repurchase transactions in 2021.[272]

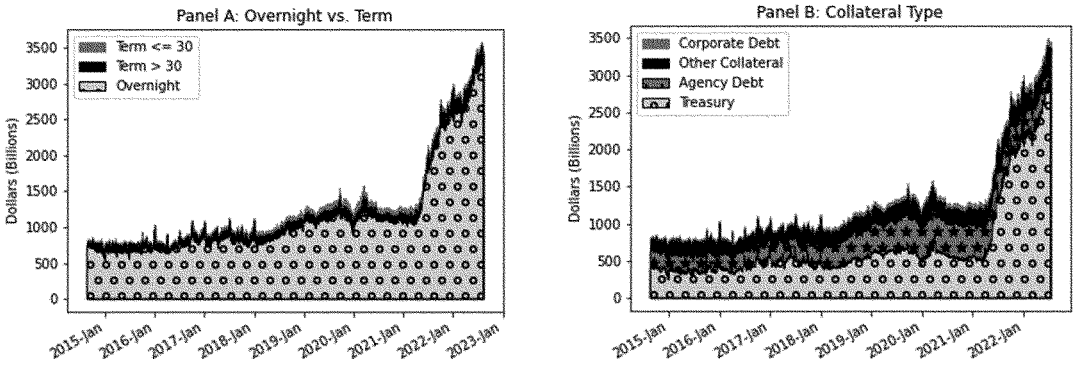
Figure 4: Daily U.S. Treasury Repurchase Transaction Volume [a]



[a] Figure 4 includes only centrally cleared bilateral repurchase as significant gaps persist in the coverage of transaction data in U.S. Treasury repo for non-centrally cleared bilateral repos. 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 $500 billion of daily trading volume in 2020, and has taken on a substantially larger role since the beginning of 2021, peaking at nearly $3 trillion in transaction volume in the beginning of 2022.[273] Of this, overnight repos is the largest segment, making up 87.5% daily transaction volume, as shown in Figure 5. Although different types of securities can be used as collateral in triparty repos, over half (50.9%) of triparty repo collateral since 2015 are U.S. Treasury securities. That number has grown to 65.5 percent since 2021, as shown in Panel B of Figure 5.[274] 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.[275]

Figure 5: Triparty Repurchase Agreement Trading Volume, Splits [a]



[a] *https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo.*

3. 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 (*see* section I, *supra*). 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.

Direct membership in FICC generally consists of banks and registered dealers,

[272] *See supra* note 150. *See also* R. Jay Kahn & Luke M. Olson, *Who Participates in Cleared Repo?* (July 8, 2021), *available at https://www.financialresearch.gov/briefs/files/OFRBr_21-01_Repo.pdf.*

[273] *See* Mark E. Paddrik, Carlos A. Ramírez, & Matthew J. McCormick, FEDS Notes: *The Dynamics of the U.S. Overnight Triparty Repo Market,* (Aug. 2, 2021), *available at https://www.federalreserve.gov/econres/notes/feds-notes/the-dynamics-of-the-us-overnight-triparty-repo-market-20210802.htm.*

[274] *See* SIFMA Research, *US Repo Fact Sheet,* at 11 (Jan. 2021), *available at https://www.sifma.org/wp-content/uploads/2020/04/2021-US-Repo-Fact-Sheet.pdf.*

[275] *Id.; see* Paddrik *et al., supra* note 273.

and such members must meet specified membership criteria.[276] In other markets, not all active participants are direct members of the clearing agency. For this reason, it is likely that under the Membership Proposal, some will access clearing indirectly. At FICC, the indirect clearing models are its Sponsored Program and a prime broker/correspondent clearing program.[277] As of May 3, 2022, FICC has 202 direct members.[278]

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 the customer 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.[279] 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.'' [280] Indeed, except for its sponsored program, because FICC nets all trades at a dealer before calculating margin, as at present, customer trades with their own dealers generate no margin requirement and are not collateralized at the CCP.

The most frequently used FICC model for accessing the clearing agency indirectly is the sponsored clearing model, which is generally used for repo but not for cash transactions. As of October 2021, there were 27 Sponsoring Members and roughly two thousand Sponsored Members from 20 approved jurisdictions, with daily volumes ranging from $225-$280 billion (and peaking in March 2020 at $564 billion).[281]

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.[282] FICC requires that its Sponsoring Members provide margin on a gross basis for its Sponsored Member positions.[283] In FICC's correspondent clearing and prime brokerage clearing models, which the Commission understands to be rarely used, the client does not have a legal relationship with FICC.[284] FICC only has CCP obligation to the correspondent clearer or prime broker itself, as applicable, who is a FICC member. In light of this, FICC net margins the activity in the accounts of correspondent clearers and prime brokers.

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.[285] 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.[286] This may 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.[287] Volumes of sponsored repo fluctuate, but they appear to be substantial as Figure 6 shows.

Figure 6: Sponsored Repo Daily Trading Volume [a]

[276] 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 47. 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.

[277] *See, e.g.,* FICC Rules, 8, 18, 3A (providing for prime brokerage and correspondent clearing, as well as sponsored membership), *supra* note 47.

[278] *See* FICC Member Directories, *available at https://www.dtcc.com/client-center/ficc-gov-directories.* (This includes all members who make use of Netting, Repurchase Netting, and/or GCF services.).

[279] *See* Chicago Fed Insights, *supra* note 204, at 2 (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.'').

[280] *Id.*

[281] *See* DTCC May 2021 White Paper, *supra* note 135, at 6.

[282] FICC–GSD Rule 3A sections 3 (membership) and 7 (novation), *supra* note 47.

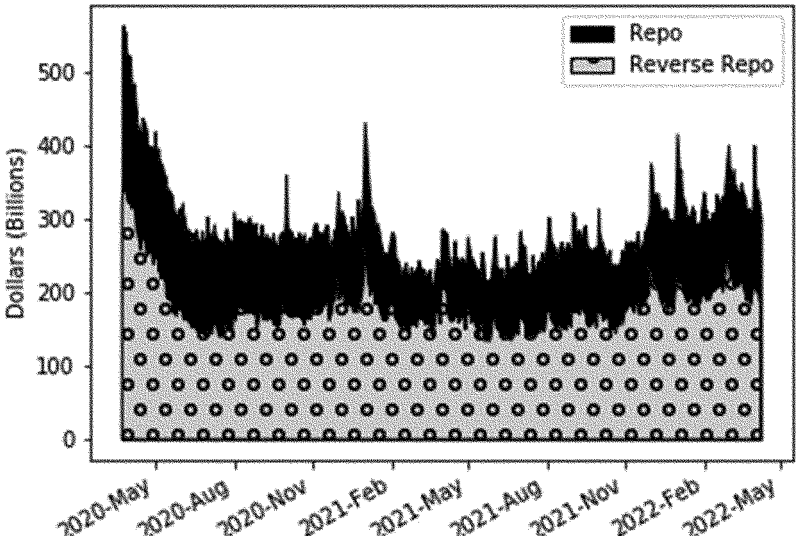
[283] FICC Rule 3A, section 10(c), *supra* note 47. *See also* DTCC October 2021 White Paper, *supra* note 203, at 5–6.

[284] FICC Rule 8, *supra* note 47. *See* DTCC October 2021 White Paper, *supra* note 203, 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.

[285] FICC Rule 3A, sections 8 and 9, *supra* note 47.

[286] FICC Rule 3, section 14(c), *supra* note 47.

[287] See *supra* note 66 and note 67 and referencing text.



[a] Source: FRBNY Repo Operations data, *available at https://www.newyorkfed.org/markets/desk-operations/repo.* Operation results in Figure 6 include all repo and reverse repo conducted, including small value exercises.

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.[288] 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.[289]

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.[290] For example, if a clearing member has a net long position in a 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.[291] 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.[292] Should additional liquid resources be required FICC could make use of the Capped Contingent Liquidity Facility (''CCLF'').[293]

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.[294] 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.[295] Thus, the members are obligated to have such resources lined up, which can be costly.[296]

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.[297] The aggregate size of the

[288] 17 CFT 240.17Ad–22(e)(4)(iii).

[289] FICC Rule 4, sections 6 and 7, *supra* note 47.

[290] 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).

[291] FICC Rule 4, sections 5 and 6, *supra* note 47.

[292] *Id.*

[293] FICC Rule 22A, section 2a, *supra* note 47.

[294] These repurchase agreements may continue for up to 30 days. *See* FICC Rule 22A, section 2a(a)(L), *supra* note 47.

[295] FICC Rule 22A, section 2a(d), *supra* note 47.

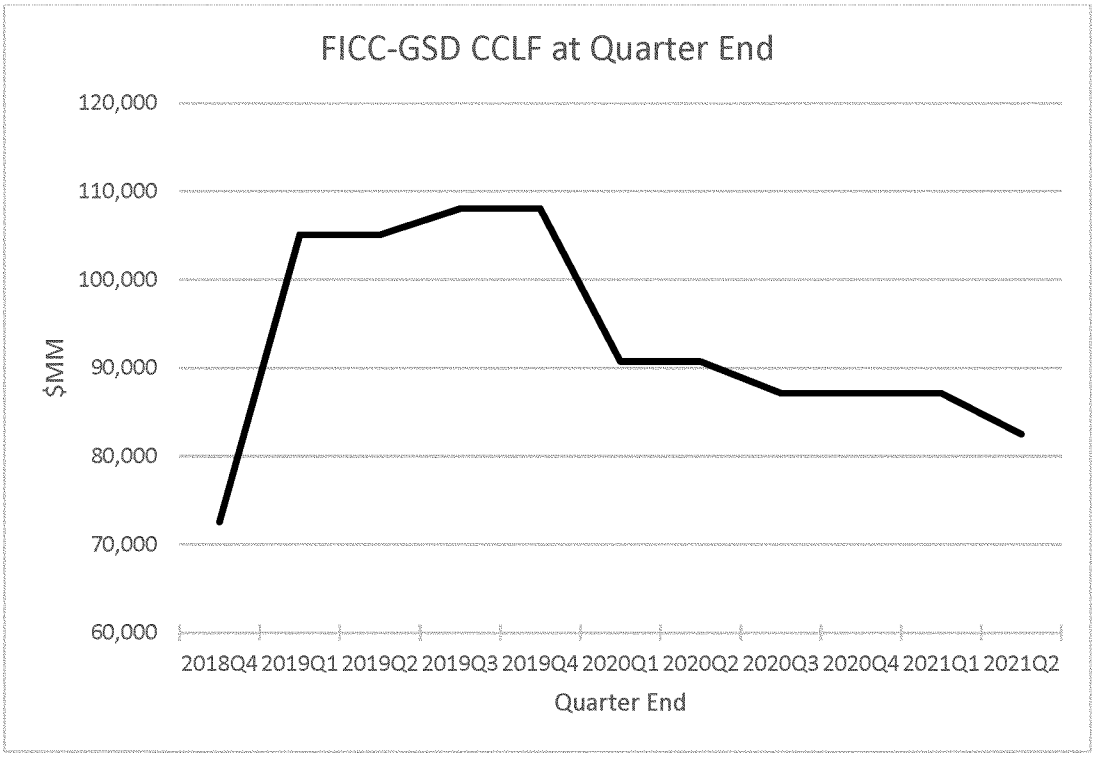
[296] *See* Independent Dealer & Trader Association, *White Paper on the Repo Market Affecting U.S. Treasury and Agency MBS,* at 8 (Dec. 6, 2019), *available at https://static1.squarespace.com/static/5ad0d0abda02bc52f0ad4922/t/5dea7fb6af08dd44e68f48cc/1575649207172/IDTA+-+White+Paper+%2812.6.19%29-c2.pdf* (''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.'').

[297] *See generally* FICC Rule 22A, section 2a(b), *supra* note 47. For details on the process, see the Order Approving a Proposed Rule Change to

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).[298]

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.[299] The size of the CCLF and each member's share is reset every 6 months or as appropriate.[300] Figure 7 provides data on the aggregate amount of the CCLF from 2018 quarter 4 through 2021 quarter 2. The aggregate size of the CCLF was over $80 billion in 2021 quarter 2.

Figure 7: Aggregate CCLF ($MM) at Quarter End [a]



[a] *See* CPMI–IOSCO Quantitative Disclosures—FICC, Disclosure Reference 7.1.6, *available at https://www.dtcc.com/legal/policy-and-compliance.*

4. Clearing and Settlement by U.S. Treasury Securities Market Segment

Data on the extent of central clearing in the U.S. Treasury securities market appears to be lacking. As discussed previously, the Commission believes that approximately half of bilateral repo trades are centrally cleared. The percentage of centrally cleared triparty repo appears to be lower than this, as sponsored triparty clearing is relatively new. For further details of central clearing in repo, see section II.A.2, *supra.*

The state of cash clearing in the U.S. Treasury securities market is discussed in section II.A.1 *supra.* 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 which one leg of a transaction facilitated by an IDB platform is centrally cleared and the other leg of the transaction is cleared bilaterally.[301]

Below, we discuss the dealer-to-customer market and the ''inter-dealer'' market (on IDBs) separately. Tables 1 and 2 show the volumes in these markets for on-the-run and off-the-run securities.

Until the mid-2000s, most inter-dealer trading occurred between primary dealers who were FICC members and it was centrally cleared.[302] 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.[303] PTFs are not generally FICC members and, as such, their trades are often not centrally cleared. Moreover, PTFs compose a

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).

[298] FICC Rule 1 (definitions of Aggregate Total Amount and Liquidity Buffer) and 22A, section 2, *supra* note 47.

[299] FICC Rule 22A, section 2a(iii), (iv), and (v), *supra* note 47. *See also* Exchange Act Release No. 82090, *supra* note 297, 82 FR at 55429–30.

[300] FICC Rule 22A, section 2a(b)(ii), (iii), (iv), and (v), *supra* note 47.

[301] *See* IAWG Report, *supra* note 4, at 30; *see also* TMPG White Paper, *supra* note 21, 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.

[302] *See* G–30 Report at 9, *supra* note 5; IAWG Report, *supra* note 4, at 5–6; TMPG White Paper, *supra* note 21, at 6.

[303] *See* Joint Staff Report, *supra* note 4, at 32, 35–36, 39.

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.[304] 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.[305]

As Tables 1 and 2 below show, during the 6-month period ending in September 2021 trading volume of on-the-run U.S. Treasury securities was approximately two and half times that of off-the-run U.S. Treasury securities. Over half (56.9%) of on-the-run U.S. Treasury security trading volume and approximately one quarter (28.5%) of off-the-run U.S. Treasury security trading volume occurred on ATSs (which are also IDBs) and non-ATS IDBs.[306] Of the on-the-run U.S. Treasury security trading volume that occurred on ATS IDBs and non-ATS IDBs, 41.5% were dealer trades, 44.6% were PTF trades and the remainder were customer trades. For off-the-run trading in U.S. Treasury securities, the comparable figures are 72.2% dealer trades, 9.1% PTF trades, and the remainder are customer trades. In contrast to trades that take place on an ATS or a non-ATS IDB, 56.9% of on-the-run U.S. Treasury security transactions and 75.9% of off-the-run U.S. Treasury security transactions are traded bilaterally. The majority of these (86.0% of on-the-run and 89.9% of off-the-run) are dealer-to-customer trades.

TABLE 1—ON-THE-RUN U.S. TREASURY SECURITIES TRADING VOLUME

On-the-Run U.S. Treasury Securities Trading Volume

	Number of venues	Average weekly volume ($M)	Volume share (%)
ATSs	18	812,480	49.7
Customer trades	11	52,754	3.2
Dealer trades	18	344,781	21.1
PTF trades	11	414,945	25.4
Non-ATS Interdealer Brokers	24	118,067	7.2
Customer trades	19	77,334	4.7
Dealer trades	23	40,252	2.5
PTF trades	9	481	[a] 0.0
Bilateral dealer-to-dealer trades	352	92,051	5.6
Bilateral dealer-to-customer trades	333	604,823	37.0
Bilateral dealer-to-PTF trades	97	7,250	0.4
Total		1,634,671	100.0

This table reports trading volume and volume share for ATSs,[b] 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. 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 6-month period, from April 1, 2021, to September 30, 2021.[c] Number of Venues is the number of different trading venues in each category and the number of distinct MPIDs for bilateral transactions.[d] Market Share (%) is the measure of the dollar volume as a percent of total dollar volume.[e] The volumes of ATSs and non-ATS interdealer brokers are broken out by Customer trades, Dealer trades, and PTF trades within each group.[f] Data is based on the regulatory version of TRACE for U.S. Treasury Securities from Apr. 1, 2021, to Sept. 30, 2021. 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.

[a] The percentage to the nearest non-zero is 0.02%.

[b] 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. See supra note 43 and referencing text.

[c] 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*.

[d] Dealers are counted using the number of distinct MPIDs.

[e] 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.

[f] 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

	Number of venues	Volume	Volume share (%)
ATSs	17	110,945	17.3

[304] *See* James Collin Harkrader & Michael Puglia, *FEDS Notes: Principal Trading Firm Activity in Treasury Cash Markets* (Aug. 2020) (''Harkrader and Puglia FEDS Note''), *available at https://www.federalreserve.gov/econres/notes/feds-notes/principal-trading-firm-activity-in-treasury-cash-markets-20200804.htm*.

[305] *See supra* note 37.

[306] The term ''IDB'' typically refers only to IDBs that are also ATSs. *See supra* note 43 and associated text.

TABLE 2—OFF-THE-RUN U.S. TREASURY SECURITIES TRADING VOLUME—Continued

Off-the-Run U.S. Treasury Securities Trading Volume	Number of venues	Volume	Volume share (%)
Customer trades	10	13,304	2.1
Dealer trades	17	83,668	13.0
PTF trades	11	13,973	2.2
Non-ATS Interdealer Brokers	22	43,604	6.8
Customer trades	18	15,092	2.4
Dealer trades	21	28,451	4.4
PTF trades	12	61	[a] 0.0
Bilateral dealer-to-dealer trades	509	47,912	7.5
Bilateral dealer-to-customer trades	333	437,665	68.2
Bilateral dealer-to-PTF trades	114	1,415	0.2
Total		641,540	100.0

This table reports trading volume and volume share for ATSs,[b] 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 6-month period, from April 1, 2021, to September 30, 2021. Market Share (%) is the measure of the dollar volume as a percent of the total dollar volume. The volumes of ATSs and nonATS interdealer brokers are broken out by Customer trades, Dealer trades, and PTF trades within each group.[c] Data is based on the regulatory version of TRACE for U.S. Treasury Securities from Apr. 1, 2021, to Sept. 30, 2021. 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.

[a] The percentage to the nearest non-zero is 0.01%.

[b] 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. See supra note 4344 and referencing text.

[c] 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.

a. Dealer-to-Customer Cash U.S. Treasury Securities Market (Off-IDBs)

i. Bilateral Clearing

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. With regard to the posting of margin, the Commission understands that most bilaterally cleared trades go unmargined.[307]

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.[308] These trades include at least one party that is not a member of the CCP. 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.[309]

ii. Central Clearing

There is essentially no central clearing of dealer-to-client trades of U.S. Treasury Securities.[310] 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 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. Instead, both parties to the trade now hold centrally cleared credit risk, and the CCP has counterparty risk to both members.

[307] TMPG White Paper, *supra* note 21, at 3 ("Margining has not been a common practice for regularly settling bilaterally cleared transactions . . .").

[308] TMPG White Paper, *supra* note 21, at 12. This figure is estimated from 2017H1 data and includes approximately 19% hybrid clearing. *See supra* section III.A.2.b (IDB Transactions) and *infra* section IV.b.4.b (iii) for discussions of hybrid clearing.

[309] TMPG White Paper, *supra* note 21, at 13.

[310] *See* G–30 Report, *supra* note 5, at 1.

b. Cash U.S. Treasury Trades Through an IDB [311]

Trades through IDBs can go through three different clearing processes, as IDBs act as the principals for the buying and selling entities transacting on the IDB who may or may not be CCP members. When the purchaser and the seller are CCP members, each leg of the trade is centrally cleared. When neither of the parties to the trade is a CCP member, conversely, each leg of the trade is cleared bilaterally. Finally, when one party to the trade is a CCP member and the other is not, the CCP member's trade is centrally cleared, while the other leg of the trade is cleared bilaterally. For clarity, we outline each of these cases separately.

i. Central Clearing

In the case where both the buyer and seller are CCP members, the process is largely the same as the process outlined in section IV.B.4.a.ii. Since all three parties, buyer, seller, and IDB are CCP members, there are just two centrally cleared trades submitted simultaneously, one between the seller and the IDB, and the other between the IDB and the buyer. Both trades are submitted to the CCP, which novates the trades, resulting in 4 separate trades. At the end of T+0, the CCP nets out the IDB's position, and sends the buyer and seller their net obligations on T+1.

The credit risk in this trade is largely the same as in the centrally cleared case without an IDB, though there is now additional counterparty credit risk on T+0 coming from the IDB's involvement in the trade. However, this additional counterparty risk is not present for very long, for two reasons. First, once the trade is submitted for clearing, counterparty risk shifts from bilateral to centrally cleared (that is, from the IDB to the CCP). Second, while the IDB holds centrally cleared credit risk, the position is netted out at the end of T+0.

ii. Bilateral Clearing

The case where the non-CCP member buyer and seller use an IDB is similar to the bilateral clearing case detailed in section IV.B.4.a(i) *supra.*[312] At execution, the trade is placed either by voice or on the IDB's electronic platform. On T+1, the IDB settles both legs of the trade. To settle its trade with the IDB, the seller instructs its settlement agent to send securities against payment to the IDB. This settlement agent then transfers the securities from the seller to the securities account of the buyer's settlement agent. The buyer's settlement agent then credits the securities to the IDB's securities account. To settle its trade with the buyer, the IDB instructs the buyer's settlement agent to transfer securities to the buyer's account, by transferring the securities from the IDB's securities account to the settlement agent's omnibus account. Finally, the clearing agent credits the securities to the buyer's securities account, which is maintained by the clearing agent. Additionally, because the IDB is principal to both parties, it can clear and settle trades on a net basis with respect to each party. This netting occurs throughout the day on T+0 and the net position is settled on T+1.

Credit risk in this scenario is different than in the centrally cleared case discussed in the previous section. Because the IDB stands as principal between the buyer and the seller but does not submit the trades for central clearing, the IDB, buyer, and seller all hold counterparty credit risk for net unsettled positions throughout T+0 and overnight on the net exposures to each party. In addition, unlike the centrally cleared case where the CCP collects margin from its counterparties, the Commission understands that IDBs generally do not collect margin to collateralize this risk.[313] Further, the IDB is now involved in settlement, making it subject to the counterparty credit risk described in section IV.B.4.a(i), *supra.* In particular, the settlement agent for the buyer faces credit extension risk from the IDB, as they deliver cash to the seller's settlement agent prior to the security being transferred. Once the securities are transferred, this risk is extinguished.

Finally, since the trade is not centrally cleared and the IDB stands as principal between the two parties, the IDB has a legal obligation to deliver securities to the buyer, even if the seller fails to deliver or defaults. In practice, an IDB might fail to deliver securities if the seller fails, generating what is known as a matched fail, where there is an expectation that the fail will be cured shortly (to the extent that it is not caused by a creditworthiness or liquidity event on the seller's part). If the seller is impaired or goes into bankruptcy, the IDB will likely source securities for delivery to the buyer, rather than carry an open fail to deliver, due to both its obligation to deliver securities as well as reputational concerns. For the same reasons the IDB will likely source cash if the buyer is impaired or goes into default. Given these obligations, the IDB actively monitors participants and their positions across its various platforms. Nevertheless, unlike a CCP, an IDB does not mutualize risk across all of the participants on its platform. As a result, compared to a CCP that collects margin and mutualizes losses among its members, if a counterparty to a bilaterally cleared trade defaults to the IDB, all else equal there is a greater risk that the IDB would then default to the other counterparty.

iii. Hybrid Clearing

In IDB trades where one counterparty to the trade is a FICC member and the other is a non-FICC member, then a hybrid clearing model is used in which one side of the trade is cleared through FICC, and the other is cleared and settled bilaterally. In these cases, the leg of the trade between the FICC member and the IDB will follow the central clearing example outlined in section IV.B.4.b.i *infra,* as FICC members are generally dealers. Similarly, the leg of the trade between the IDB and the non-FICC member will be bilaterally cleared as described in section IV.B.4.b.ii *supra,* as the non-FICC entities trading on IDBs are generally PTFs and other unregistered market participants.

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.[314] Varying bespoke arrangements appear to characterize current margining practices in the bilateral, non-centrally cleared cash market.[315] Indeed, a recent publication stated that competitive pressures in the bilaterally settled market for repo transactions has exerted downward pressure on haircuts, sometimes to zero.[316] The reduction of haircuts, which serve as the primary counterparty credit risk mitigant in bilateral repos, could result in greater exposure to potential counterparty default risk in non-centrally cleared repos. Such arrangements (in both cash

[311] *See generally* TMPG White Paper, *supra* note 21.

[312] *See also* TMPG White Paper, *supra* note 21, at 23.

[313] *See* TMPG White Paper, *supra* note 21, at 3.

[314] TMPG White Paper, *supra* note 21, at 3.

[315] *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.*

[316] G–30 Report, *supra* note 5, at 13.

and 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. 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 rises with volatility in the U.S. Treasury securities market.[317] 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.[318]

FICC Rules set forth the various components of a member's margin requirements.[319] 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 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 overcollateralization. That is, if a lender is providing $100 of cash, the borrower will provide more than $100 of securities as collateral. This extra collateral—which is essentially a form of initial margin—protects the lender by making it more costly for the borrower to default, while also protecting the lender against the risk that short-term volatility erodes the value of the posted collateral. The difference between the cash provided and the value of the collateral is known colloquially as a ''haircut.'' Triparty repo also features overcollateralization, where the haircut is again negotiated bilaterally between the two counterparties.[320] 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.[321] Money market funds also generally require margin of 2%, which is generally the case for other investment companies as well.[322] Outside of money market funds and other investment companies, due to the lack of 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.[323]

While overcollateralization protects the lender, the bilaterally cleared repo market generally does not feature the same level of protection for the borrower. Indeed, one of the main benefits of the bilateral market to lenders is that it allows them to reuse the collateral. As a result, borrowers are exposed to settlement risk and must manage that risk as they see fit. In the triparty repo market, posted collateral remains in the custody of the clearing bank and cannot be reused by the lender except as collateral in another triparty repurchase agreement, reducing settlement risk for the borrower.

Unlike bilaterally cleared and triparty repo, centrally cleared repo generally does not feature overcollateralization. Instead, the counterparties post cash margin to the CCP twice per day, as they do with trades in the cash market. Borrowers may be required to post more margin than lenders, similar to how in the bilaterally cleared market borrowers post margin through overcollateralization while lenders 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.[324] U.S. 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.[325] This makes events that reduce liquidity in these markets especially striking and destabilizing to the overall market.

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.[326] For example, hedge funds, one of the principal sellers of U.S Treasury futures, hedge their short futures position by

[317] *See* FICC Rule 4, section 1b, *supra* note 47. 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.

[318] *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.*

[319] FICC Rule 4, section 1b, *supra* note 47.

[320] 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 273.

[321] For data on the median, 10th, and 90th percentiles of overcollateralization in Triparty repo, see *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 June 2022. 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 2010 and again briefly in September 2012—while the 90th percentile has occasionally spiked to as high as 5%—specifically in January 2017 and again in April of the same year.

[322] *See* MMF Primer, *supra* note 57.

[323] *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.'').

[324] *See* IAWG Report, *supra* note 4, for further discussion of these and other disruptions.

[325] U.S. Treasury securities are often used as substitutes for cash. There is anecdotal evidence that during March 2020, some market participants refused U.S. Treasury securities collateral in favor of cash.

[326] *See* U.S. Credit Markets Interconnectedness and the Effects of the COVID–19 Economic Shock (Oct. 2020) at 3.

establishing a long position in the cash market, creating a ''cash-futures basis trade.'' 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.[327]

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.[328] This may, as discussed above, have led to the winding down of the cash-futures basis trade, for example, adding to further stress.[329] There also appeared to be large-scale selling from foreign investors, including official institutions, to address their domestic currency and liquidity needs.[330]

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 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.[331] One view of central clearing is that it may facilitate all-to-all trading, thus helping ultimate buyers and sellers find each other.[332] 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—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 flow away from bank reserves, bringing them down to their lowest level in 5 years.[333] Moreover, the auction settlement raised the number 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 would have attracted other market participants. Ultimately, as 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 be dictated 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 in an increase in the cost of borrowing. 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.[334] 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,[335] PTFs significantly reduced the dollar amounts of standing quotes in central limit order books,[336] leading to greater pressure on the system. This withdrawal of liquidity appears to have

[327] *Id.* 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 id.*

[328] Duffie, *supra* note 186.

[329] *See supra* note 150.

[330] *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.*

[331] Duffie, *supra* note 186; Liang & Parkinson, *supra* note 32.

[332] *See* Duffie *supra* note 186.

[333] *See* Sriya Anbil *et al., What Happened in Money Markets in September 2019?* (Feb. 27, 2020), *available at https://www.federalreserve.gov/econres/notes/feds-notes/what-happened-in-money-markets-in-september-2019-20200227.htm.*

[334] *See generally* Joint Staff Report, *supra* note 4.

[335] *See* Joint Staff Report, *supra* note 4, at 21.

[336] *See* IAWG Report, *supra* note 4, at 18.

been motivated by an attempt to manage risk. Lastly, though broker-dealers increased their trading volume, they provided less liquidity to the order books by widening their spreads and in some cases withdrawing for brief periods from the offer side of the book.[337]

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.[338] 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 Persons

a. Covered Clearing Agencies for U.S. Treasury Securities: FICC

Although the Membership Proposal 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.[339] In 2021 and 2020, FICC's total clearing revenue was approximately $310 and $297.3 million, respectively, and its net income was approximately $13.4 and 18.1 million, respectively.[340]

The G–30 Report estimated that ''roughly 20 percent of commitments to settle U.S. Treasury security trades are cleared through FICC.'' [341] Although various analyses have noted the increased volume of secondary market U.S. Treasury transactions that are not centrally cleared,[342] the dollar value of transactions FICC clears remains substantial. In 2021, FICC's GSD processed $1.419 quadrillion in U.S. Government securities.[343] 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].'' [344]

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.[345] 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 reverse repo is centrally cleared via FICC.'' [346] Measured by dollar volume, repos, according to DTCC, are the largest component of the government fixed-income market.[347] 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.[348] For all of 2021, DTCC reported that FICC processed $251 trillion through its GCF Repo Service.[349]

b. Direct Participants at U.S. Treasury Securities CCAs: FICC Netting Members

If adopted, the Membership Proposal 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 May 3, 2022, FICC's GSD had 202 Netting Members of which 187 were participants in FICC's repo netting service.[350] FICC Netting Members generally consist of bank-affiliated dealers and registered broker-dealers. These dealers include all 25 financial institutions currently designated by the Federal Reserve Bank of New York (N.Y. Fed) as ''primary dealers.'' [351] In 2021, the average daily trading dollar value in U.S. Treasury securities by primary dealers was $624.1 billion.[352] The relative significance of dealer trading in the cash market for U.S. Treasury securities can is shown in Figure 8.

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[337] *See id.*

[338] *See id.*

[339] *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).

[340] FICC, Financial Statements as of and for the Years Ended Dec. 31, 2021 and 2020, *available at https://www.dtcc.com/-/media/Files/Downloads/legal/financials/2021/FICC-Annual-Financial-Statements-2021-and-2020.pdf*

[341] G–30 Report, *supra* note 5, at 11.

[342] *See, e.g.,* IAWG Report, *supra* note 4, at 5–6 (citing TMPG White Paper); 2017 Treasury Report, *supra* note 16, at 81; Joint Staff Report, *supra* note 4, at 36–37.

[343] Performance Dashboard, DTCC 2021 Annual Report, at 56, *available at https://www.dtcc.com/~/media/files/downloads/about/annual-reports/DTCC-2021-Annual-Report.* 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.

[344] DTCC May 2021 White Paper, *supra* note 135, at 3.

[345] *See* IAWG Report, *supra* note 4, at 30; *see also* TMPG White Paper, *supra* note 21, at 12.

[346] Sebastian Infante, *et al.,* supra note 119 (''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.*

[347] DTCC, *A Guide to Clearance and Settlement, Chapter 8: Settling Debt Instruments, available at: https://www.dtcc.com/clearance-settlement-guide/#/chapterEight.*

[348] Finadium, *Building Out Industry Data for New Industry Leads,* at 9 (2021), *available at: https://finadium.com/wp-content/pdfs/finadium-dtcc-building-out-repo-data.pdf.*

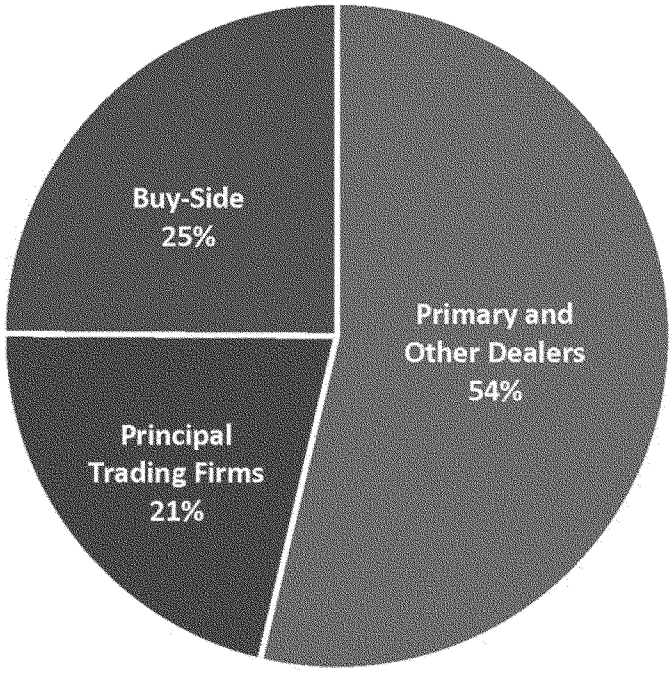
[349] DTCC 2021 Annual Report, *supra* note 343, at 56.

[350] FICC GSD Member Directory, *available at: https://www.dtcc.com/-/media/Files/Downloads/client-center/FICC/Mem-GOV-by-name.xlsx.* 104 Netting Members participated in FICC's GCF service.

[351] 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. *https://home.treasury.gov/policy-issues/financing-the-government/quarterly-refunding/primary-dealers.* A current list of primary dealers is available at: *https://www.newyorkfed.org/markets/primarydealers.*

[352] SIFMA, *2022 Capital Markets Fact Book,* at 56 (July 2022) *available at https://www.sifma.org/wp-content/uploads/2022/07/CM-Fact-Book-2022-SIFMA.pdf* (SIMFA'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 1.9 percent for the ten year period ending in 2021.

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 December 31, 2019. Figure from Harkrader and Puglia FEDS Note, *supra* note 305. 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.*

As previously discussed, the total notional transactions in the repo market is larger than that of the cash U.S. Treasury securities market. In 2021, 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).[353] As of December 31, 2021, the repo market as a whole was valued at approximately $5.8 trillion.[354] 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.'' [355] 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.'' [356] *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 tri-party 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 (approximately 8 percent) are not centrally cleared but settle on the triparty platform. 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.[357]

Figure 9 Repo Clearing 2021–2022

[353] SIFMA Research, *US Repo Markets: A Chart Book, at 6, 7, and 8* (Feb. 2022), *available at* 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.

[354] 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.*

[355] DTCC 2021 Annual Report, *supra* note 343, at 32.

[356] 2022 Fed Note, *supra* note 346.

[357] *Id.*

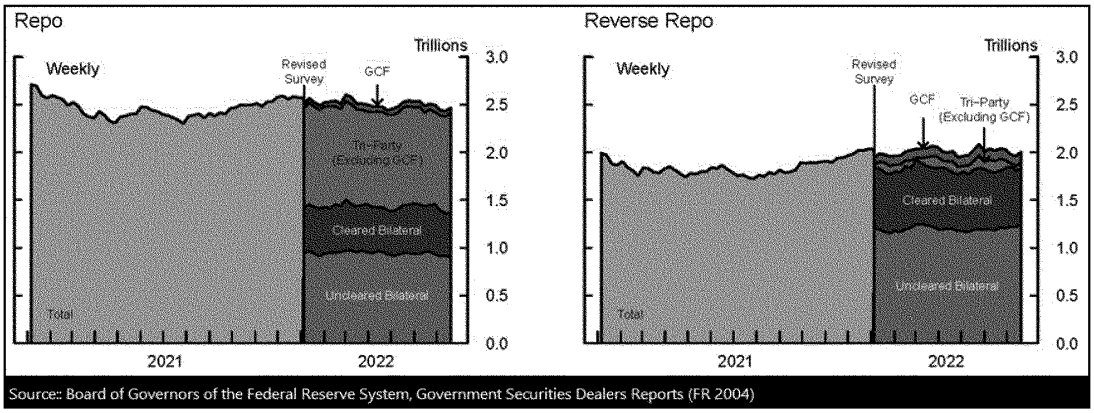
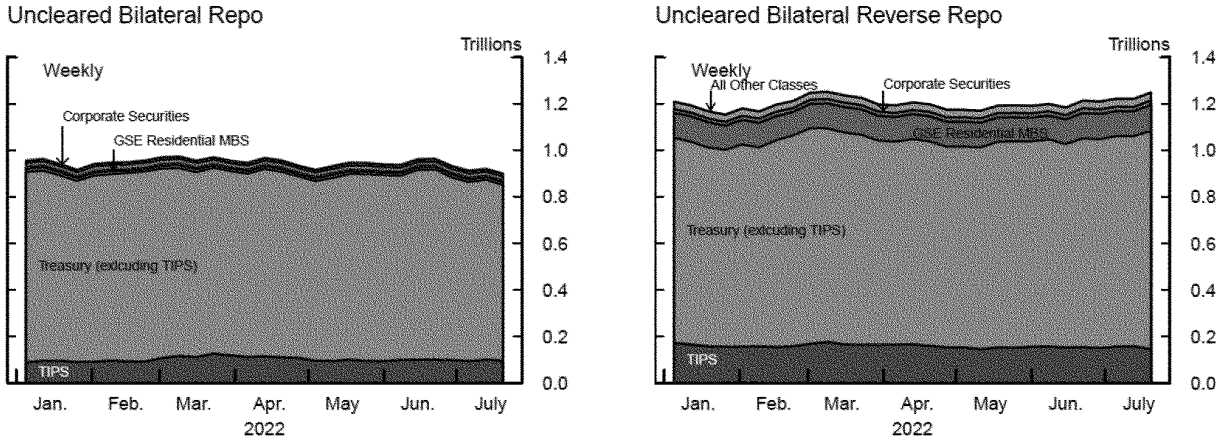
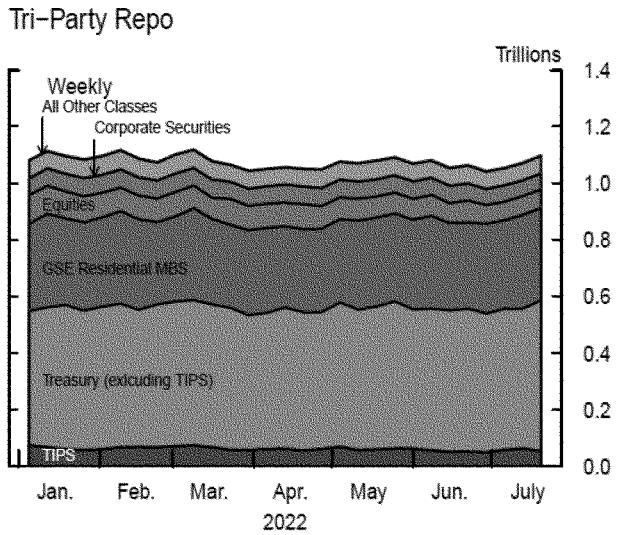


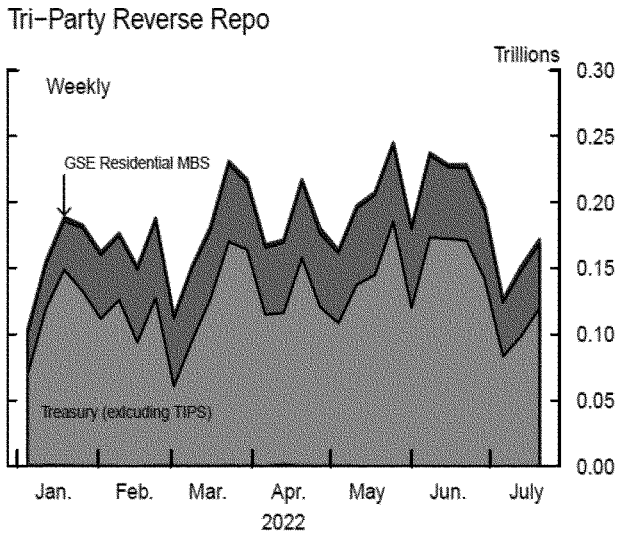
Figure 10 Uncleared Bilateral Repo and Reverse Repo Collateral 2022



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)

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c. Interdealer Brokers (IDBs)

Interdealer brokers [358] 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, the Commission believes most IDBs are FICC Netting Members.[359] In any event, 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 above in section II.A.1, 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. If the buyer or seller is a dealer, the respective leg is centrally cleared. Transaction legs involving PTFs are generally cleared and settled bilaterally.

TMPG estimates that ''roughly three-quarters of IDB trades clear bilaterally.'' [360] 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 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 on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities (2019), 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 October 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.

[358] 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.

[359] *See generally* TMPG White Paper, *supra* note 21. 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.'' TMPG White Paper at 2.)

[360] TMPG White Paper, *supra* note 21, at 2.

d. Other Market Participants

i. FICC Sponsored Members

As discussed previously, some institutional participants that are not FICC Netting Members/FICC direct participants are able to centrally clear repos through FICC's Sponsored Service.[361] 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. If adopted, the Membership Proposal 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.[362] Following FICC's expansion in 2021 of its Sponsored Service to allow Sponsored Members to clear triparty repos through the program,[363] there are now approximately 30 Sponsoring Members and approximately 1,900 Sponsored Members [364] with access to central clearing. During the 12 month period ending on August 9, 2022, the total dollar value of Sponsored Members' daily repo and reverse repo activity ranged from a high of $415.8 billion on December 31, 2021 to a low of $230.2 billion on October 21, 2021.[365]

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 ETFs; [366] (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.[367]

ii. Other Market Participants That Are Not FICC Sponsored Members

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 engage in secondary market transactions, we expect their trading may be affected by increased central clearing resulting from the adoption of the Proposal. The most prominent examples are:

1. 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 have been shown to be a cause of price movements in the U.S. Treasury securities market.[368] Hedge funds can use U.S. Treasury securities, for example, in order to borrow cash to take leveraged positions in other markets, or to execute complex trading strategies. As of December 31, 2021 approximately 25 percent of qualifying hedge funds reporting on Form PF [369] reported U.S. Treasury securities holdings totaling $1.76 trillion in notional exposure in the cash market and $2.25 trillion in notional exposure to repos.[370] For Large Hedge Fund Advisers (LHFA) [371] reporting on Form PF for the same period, monthly turnover in U.S. Treasury securities was $3.4 trillion.

Family offices are entities established by families to manage family wealth.[372] Family offices tend to exhibit behavior and have objectives that are similar to those of hedge funds including the use of leverage, aggressive investment strategies, and holding illiquid assets. A recent survey of family offices undertaken by RBC [373] found that of 385 participating family offices around the world, almost 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 wealthy individual investors. Because of the end investor's risk tolerance, SMAs can also pursue aggressive, leveraged strategies.

[361] 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.

[362] *See* FICC's GSD Rule 3A, *supra* note 47. 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).

[363] *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), *supra* note 126.

[364] *See FICC Membership Directories* (''FICC Membership''), *available at https://www.dtcc.com/client-center/ficc-gov-directories.* As of Dec. 31, 2021, DTCC reported that FICC had 30 sponsoring members and over 1,800 sponsored members. DTCC 2021 Annual Report, *supra* note 343, at 19.

[365] This information was available from DTCC on the 1 year version of the FICC Sponsored Activity chart as of Aug. 12, 2022, *available at: https://www.dtcc.com/charts/membership.*

[366] 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.'' Chicago Fed Insights, *supra* note 204.

[367] FICC Membership, *supra* note 364.

[368] 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.*

[369] For an explanation of qualifying hedge funds, see *supra* note 148. 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.*

[370] Division of Investment Management Analytics Office, Private Funds Statistics Fourth Calendar Quarter 2021, Table 46 at 39 (July 22, 2022), *available at https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q4.pdf.*

[371] Large hedge fund advisers reporting on Form PF ''have at least $1.5 billion in hedge fund assets under management.'' *See Id.* at 61.

[372] ''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, *available at https://www.sec.gov/rules/final/2011/ia-3220-secg.htm.*

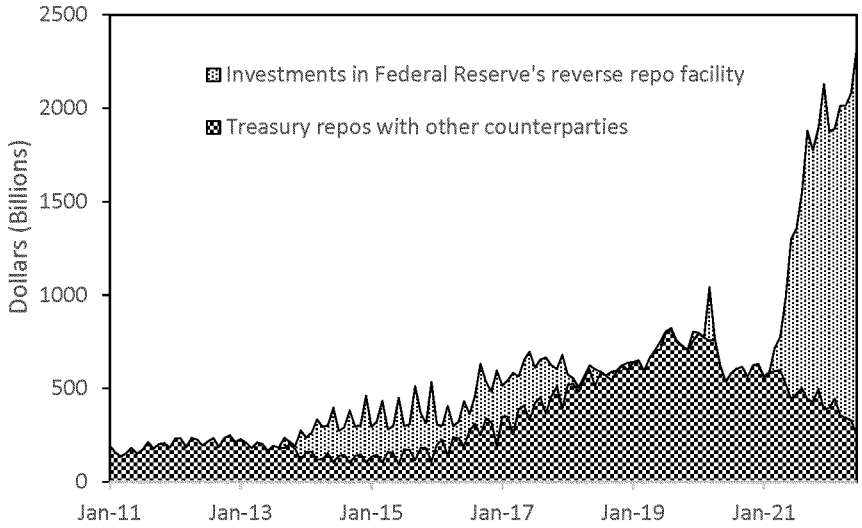
[373] Campden Wealth and The Royal Bank of Canada, *The North America Family Office Report* (2021), *available at: https://www.rbcwealthmanagement.com/_assets/documents/cmp/the-north-america-family-office-report-2021-final-ua.pdf.*

2. 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.[374] At the end of the first quarter of 2022, money market funds held $1.8 trillion of U.S. Treasury securities ($1.2 trillion in T-Bills and $603.9 billion in other U.S. Treasury securities).[375] Mutual funds held an additional $1.5 trillion of other U.S. Treasury securities ($34.1 billion of T-Bills and $1.5 trillion of other U.S. Treasury securities) while exchange-traded funds held an additional $334.1 billion in U.S. Treasury securities.[376] The degree to which these entities would be affected depends on the extent to which their trading is likely to take place in the secondary market.[377]

RICs are also active participants in the repo market with money market funds being active cash investors. According to data filed with the Commission, money market funds investments in U.S. Treasury repo, both bilateral and triparty, amounted to approximately $2.3 trillion in June 2022. 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.[378]

Figure 12: Money Market Fund Monthly Repo Volume (01/2011–06/2022)



Source: SEC Form N-MFP

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 RICs had net sales of $128 billion in Treasury and agency bonds, mainly to meet redemption requests at the onset of the Covid-19 pandemic.[379]

In addition to reliance on Treasury securities as sources of liquidity, RICs use Treasury securities as collateral for borrowing in the repo market as another source of liquidity. Also, RICs accept Treasury securities as collateral in their securities lending programs established to an additional source of income for the fund shareholders.

[374] Investment companies are the third largest holder of U.S. Treasury securities holding just under $3.6 trillion. MMFs in the Treasury Market, *supra* note 128, at 3 (citing to Financial Accounts of the United States as of Mar. 2022). The other large (over 5 percent) holders are: ''other'' holders (including hedge funds) 30 percent, the Federal Reserve (23 percent), pension funds (14 percent), and U.S. banks and state and local governments (each holding 6 percent). *See id.* at 2 (figure 5).

[375] 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.*

[376] *Id.* at 119 (L210 Treasury Securities—lines 45–47 and 49).

[377] 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. Recently published estimates based on monthly filings of Form N–MFP suggest that, on average, money market funds hold around 70 percent of U.S. Treasury securities to the next month with around 6 percent of U.S. Treasury securities holdings disposed of before maturity. The remaining approximately 23 percent of holdings mature during the month. MMFs in the Treasury Market, *supra* note 128, at 3. These estimates suggest that the proposal's effect on money market fund cash market transactions in U.S. Treasury securities will be very limited relative the proposal's effects on money market funds' repo activities which could be more significant.

[378] *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.

[379] *See* Shelly Antoniewicz & Sean Collins, *Setting the Record Straight on Bond Mutual Funds' Sales of Treasuries,* Investment Company Institute Viewpoints (Feb. 24, 2022), *available at https://www.ici.org/viewpoints/22-view-bondfund-survey-2.*

3. 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.[380] 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 that were not members of FINRA.[381] 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.'' [382] 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 platforms . . . .[383]

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 Membership Proposal would subject as much as approximately $116.51 billion per day in PTF trades on electronic/automated IDBs to central clearing.[384]

4. State and Local Governments

State and local governments are significant holders of U.S. Treasury securities. As of March 2022, state and local governments held approximately $1.5 trillion in U.S. Treasury securities [385] as part of their budgetary and short-term investment duties.

5. Private Pensions Funds and Insurance Companies.

Insurance companies and pension funds also have significant positions in U.S. Treasury securities. As of March 2022, private pension funds and insurance companies are large holders of U.S. Treasury securities, holding $5.6 trillion and $374.8 billion respectively.[386]

e. Triparty Agent: Bank of New York Mellon [387]

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.[388] 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 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.[389]

An expansion of central clearing under the Membership Proposal 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 tri-party repo transaction that isn't centrally cleared, a custodian perform 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.[390]

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 participants.[391] 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

[380] *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 Note, *supra* note 304; Doug Brain, *et al.,* FEDS Notes, ''Unlocking the Treasury Market Through TRACE'' (Sept. 28, 2018), *available at https://www.federalreserve.gov/econres/notes/feds-notes/unlocking-the-treasury-market-through-trace-20180928.htm. See also* Ryan and Toomey Blog Part III, *supra* note 31 (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* 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.'').

[381] 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 FINRA 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.

[382] *Id.* at 23072.

[383] *Id.* at 23080. Harkrader and Puglia FEDS Note, *supra* note 304. *See also* FEDS Notes, Unlocking the Treasury Market Through TRACE (Sept. 28, 2018). 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 December 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.*

[384] Harkrader and Puglia FEDS Note, *supra* note 304, at table 1 (61% of $191 billion = $116.51 billion).

[385] Financial Accounts of the U.S., *supra* note 375 (Line 19).

[386] *Id.* (Lines 29, 32, and 35).

[387] Paddrik, *et al., supra* note 273 (''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.'').

[388] J.P. Morgan Chase previously served as a custodian in the triparty space but largely exited the market in 2019. *Id.* at 2–3.

[389] *See supra* note 66 and accompanying discussion.

[390] *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*

[391] *See Fedwire Securities Service brochure* (''FSS brochure''), *available at: https://www.frbservices.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. Service fees are available at FRBservices.org. Fees for services are set by the Federal Reserve Banks. A 2022 fee schedule is *available at: https://www.frbservices.org/resources/fees/securities-2022*

obligations, and to facilitate repo transactions.[392]

C. Analysis of Benefits, Costs, and Impact on Efficiency, Competition, and Capital Formation

1. Benefits

The proposed amendments would 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 registered clearing agencies that provide CCP services both reduce trading costs and help increase the safety and efficiency of securities trading.[393] These benefits could be particularly significant in times of market stress, as CCPs would 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.[394] A CCP also would address concerns about counterparty risk by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity of counterparties.[395] 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.'' [396] However, the Commission has also recognized that this centralization of activity at clearing agencies makes risk management at such entities a critical function.[397]

Bilateral clearing arrangements do not allow for multilateral netting of obligations, which reduce end-of-day settlement obligations.[398] 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 reduces the magnitude of cash and securities flows required at settlement.[399] These reductions, particularly in cash and securities flow ''would reduce liquidity risks associated with those settlements and counterparty credit risks associated with failures to deliver on the contractual settlement date,'' not only for CCP members but for the CCP itself.[400]

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.[401] 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.[402]

The benefits of multilateral netting flowing from central clearing can improve market safety by lowering exposure to settlement failures.[403] Multilateral netting can also reduce the regulatory capital required to support a given level of intermediation activity [404] 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.[405] By reducing the level or margin required to support a 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.[406]

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 off against the exact 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.[407] According to research that Finadium conducted among repo dealers, netting can compress High Quality Liquid Asset (HQLA) bilateral trading books by 60% to 80%.[408]

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.[409] 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.[410] As the Commission believes that this proposal will incentivize and facilitate additional central clearing in the U.S. Treasury

[392] FSS brochure, *supra* note 391.

[393] *See supra* note 7.

[394] *See supra* note 8.

[395] *Id.*

[396] *See supra* note 10.

[397] *Id.*

[398] See section IV.A.1, *supra* for a discussion of central clearing and the mitigation of clearance and settlement risks.

[399] *See* IAWG Report, *supra* note 4, at 30.

[400] *See* G–30 Report, *supra* note 5, at 13, *supra* note 5; *see also* PIFS Paper, *supra* note 120, at 28–31.

[401] *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), *available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf.*

[402] PIFS Paper, *supra* note 120, at 29 (citing OFFICE OF FINANCIAL RESEARCH, Benefits and Risks of Central Clearing in the Repo Market, 5–6 (Mar. 9, 2017), *available at https://www.financialresearch.gov/briefs/files/OFRBr_2017_04_CCP-for-Repos.pdf*).

[403] Duffie, *supra* note 186, at 15.

[404] *See* section IV.A.2, *supra* for an example of how multilateral netting can reduce margin required to support a given level of trading activity.

[405] *See* IAWG Report, *supra* note 4, at 30; Liang & Parkinson, *supra* note 32, at 9; Duffie, *supra* note 186, 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 186, 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.'').

[406] See Menkveld and Vuillemey, 2021, *Annual Review of Financial Economics.*

[407] 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 section C.2 *infra.*

[408] Finadium LLC, Netting Rules for Repo, Securities Lending and Prime Brokerage (Sept. 2014). 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 liquidity-generating capacity is assumed to remain intact even in period of severe idiosyncratic and market stress. *See https://www.bis.org/basel_framework/chapter/LCR/30.htm?tldate=20191231&inforce=20191215.*

[409] *See* TMPG Repo White Paper, *supra* note 118, at 1. *See also* section IV.B.5, *supra.*

[410] G–30 Report, *supra* note 5, at 13; 17 CFR 240.17Ad–22(e)(6).

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.[411]

The Commission also believes that this proposal would 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, often subject to bilaterally negotiated contracts with little 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.[412]

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.[413]

As discussed further below, the Commission is unable to quantify certain economic benefits and solicits comment, including estimates and data from interested parties, that could help inform the estimates of the economic effects of the proposal.

a. U.S. Treasury Securities CCA Membership Requirements

The Commission is proposing to amend 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 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 covered clearing agency.[414] As previously explained in section III.A.2 *supra,* an eligible secondary market transaction in U.S. Treasury securities would be 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 fund;[415] 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.[416] 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.

The proposed amendment to Rule 17Ad–22(e)(18) would 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 would result in achieving the benefits associated with an increased level of central clearing discussed in section IV.C.1 *supra.*

i. Scope of the Membership Proposal

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.[417] The Commission believes that covered clearing agency members not centrally clearing cash or repo transactions in U.S. Treasury securities creates 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.[418] However, FICC's rules do not require its direct participants, such as IDBs, to submit either cash or repo transactions[419] with persons who are not FICC members for central clearing.

The expanded scope of the Membership Proposal would reduce instances of ''hybrid'' clearing, where FICC lacks visibility on the bilaterally cleared component of a trade. As previously mentioned in section II.A.1 *supra,* 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 management.[420] The Membership Proposal would not only result in the consistent and transparent application of risk management

[411] ''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.

[412] *See* TMPG White Paper, *supra* note 21, at 32.

[413] Duffie, *supra* note 186, at 15; DTCC October 2021 White Paper, *supra* note 203, at 1; IAWG Report, *supra* note 4.

[414] *See supra* section III.A.

[415] 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* section III.A.2.b (Other Cash Transactions), *supra.*

[416] *See* section III.A.2.b (Other Cash Transactions), *supra.*

[417] *See* DTCC May 2021 White Paper, *supra* note 135, at 5; IAWG Report, *supra* note 4, at 6.

[418] *See* note 101 *supra.*

[419] With regard to Sponsored GC Repos, *see* note 102.

[420] IAWG Report, *supra* note 4, at 30; G–30 Report, *supra* note 5.

requirements to trades that are now bilaterally cleared but would also increase the CCA's awareness of those trades, which it now lacks.[421]

ii. Application of the Membership Proposal to Repo Transactions

The Commission proposes to require 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 section 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 central clearing.[422]

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.[423] Nonetheless, the Commission understands that, among bilaterally settled repo, approximately half was centrally cleared as of 2021.[424] 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 should increase the fraction of total volume of such transactions submitted for central clearing realizing the benefits described above in section IV.C.1 *supra.* In addition, because repo participants are generally large, sophisticated market players, the requirement for repo transactions will cover a set of market participants that already have built most of the necessary processes and infrastructure to comply with the rule.

iii. Application of the Membership Proposal 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.[425] The Commission has identified certain categories of purchases and sales of U.S. Treasury securities that it believes should be part of the Membership Proposal, *i.e.,* for which U.S. Treasury securities CCAs would be obligated to impose 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 section 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 proposing that all cash market transactions completed with a FICC member be centrally cleared.[426]

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 may capture a large fraction of market activity while also capturing the most active market participants who may already have some ability to connect with the clearing agency and experience with central clearing.

a. IDB Transactions

The Commission proposes 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 Membership Proposal. This requirement would encompass the transactions of those entities serving as IDBs in the U.S. Treasury securities market, in that it would cover entities that are standing in the middle of transactions between two counterparties that execute a trade on the IDB's platform.[427]

If adopted, the proposal 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 clear all of their trades will give FICC better insight into the risk position of its clearing members though 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 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,[428] IDBs act as central nodes in the system, in effect serving as clearing agencies without the regulatory structure of clearing agency. Furthermore, the netting benefits to IDBs, as described in section IV.c.1 *supra* 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.

[421] *See supra* note 258.

[422] TMPG Repo White Paper, *supra* note 123, at 1.

[423] IAWG Report, *supra* note 4, at 29.

[424] *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 118, at 1; Katy Burne, "*Future Proofing the Treasury Market,*" BNY Mellon Aerial View, supra note 118, at 7 (noting that 63% of repo transactions remain non-centrally cleared according to Office of Financial Research data as of Sept. 10, 2021).

[425] *See supra* note 21.

[426] The G–30 report recommends an approach to clearing all of repo, and some cash trades. *See generally* G–30 Report, *supra* note 5.

[427] *See supra* section II.A.1 for further discussion of IDBs and their role in the cash market for U.S. Treasury securities.

[428] *See generally* G–30 Report, *supra* note 5.

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.[429] 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.[430] 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 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.[431] 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.[432] 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.[433] The Membership Proposal would 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.

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.

First, the Commission is proposing that the definition of an eligible secondary market transaction includes those cash purchase and sale transactions in which the counterparty of the direct participant is a registered broker-dealer, government securities broker, or dealer.[434] 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.[435] 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.

Second, the Commission proposes that transactions between a direct participant and hedge funds be included in the Membership Proposal. This aspect of the proposal would employ a definition of a hedge fund consistent with that in Form PF.[436]

The proposed requirement seeks to reach funds that are leveraged and that may use trading strategies that involve derivatives, complex structured products, short selling, high turnover, and/or concentrated investments, which may, in turn, present more potential risk to a U.S. Treasury securities CCA through a form of the contagion risk discussed above. When discussing a proposal using a similar standard to define a hedge fund, the Commission recognized that strategies employed by hedge funds, in particular high levels of leverage ''can increase the likelihood that the fund will experience stress or fail, and amplify the effects on financial markets.'' [437] The Commission also stated that ''significant hedge fund failures (whether caused by 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. These losses could have systemic implications if they require these financial institutions to scale back their lending efforts or other financing activities generally. The simultaneous failure of several similarly positioned hedge funds could create contagion through the financial markets if the failing funds liquidate their investment positions in parallel at fire-sale prices, thereby depressing the mark-to-market valuations of securities that may be widely held by other financial institutions and investors.'' [438] Through the central clearing of transactions effected by funds and other leveraged accounts, the Commission expects to mitigate the risks attendant to a simultaneous failure of hedge funds or other similar market participants, thus reducing contagion.

Third, the Commission proposes to include within the definition of an eligible secondary market transaction subject to the Membership Proposal 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.[439] As discussed above, the Commission believes that the inclusion of transactions with such accounts should allow the proposal to encompass transactions between direct participants of a U.S. Treasury securities CCA and a

[429] *See, e.g.,* TMPG White Paper, *supra* note 21, 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.'').

[430] *See* DTCC May 2021 White Paper, *supra* note 135, at 5.

[431] See supra note 7.

[432] TMPG White Paper, *supra* note 21, at 32.

[433] *See id.*

[434] 15 U.S.C. 78o(a) and 78o–5(a) (requirement to register) and 78c(4), (5), (43), and (44) (definitions).

[435] *See supra* note 218 and referencing text describing several methods available to allow market participants to access CCP services through a FICC member.

[436] *See supra* section III.A.2.b (Other Cash Transactions) for a discussion of the definition of hedge fund in the proposed rule and its consistency with that in Form PF Glossary of Terms. *See also* note 143.

[437] *See supra* note 145.

[438] *Id.* at 21.

[439] *See supra* section III.A.2.b (Other Cash Transactions).

prime brokerage account, which, based on the Commission's supervisory knowledge, may hold assets of private funds and separately managed accounts and that may use leverage that poses a risk to U.S. Treasury securities CCA and the broader financial system similar to that of hedge funds as described above. Covering such accounts would also allow for inclusion of, for example, accounts used by family offices or separately managed accounts that may use strategies more similar to those of a hedge fund.

c. Exclusions From the Membership Proposal

The Commission is proposing to exclude certain otherwise eligible secondary market transactions in U.S. Treasury securities from the Membership Proposal. 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 proposing to exclude from the Membership Proposal 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 bank.[440] For similar reasons, the Commission is also proposing to exclude from the Membership Proposal 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.[441]

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.[442] Further, the Commission believes that the exclusion should extend to foreign central banks, sovereign entities and international financial institutions for reasons of international comity.[443] In light of ongoing expectations that Federal Reserve Banks and agencies of the Federal government would 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 also proposes to exclude transactions between U.S. Treasury CCA members and natural persons from the Membership Proposal. The Commission believes that natural persons generally transact in small volumes and would 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.

iv. Policies and Procedures Regarding Direct Participants' Transactions

The Commission is proposing Rule 17Ad–22(e)(18)(iv)(B) that would require that a U.S. Treasury securities CCA establish 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 Membership Proposal 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 Membership Proposal.

b. Other Changes to Covered Clearing Agency Standards

The Commission believes that certain additional changes to its Covered Clearing Agency Standards that would 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.

i. Netting and Margin Practices for House and Customer Accounts

The Commission is proposing amendments to 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. 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,[444] 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.[445]

Under the proposed amendments to Rule 17Ad–22(e)(6)(i), a U.S. Treasury securities CCA would be 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 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 would also be required to have policies and procedures reasonably designed to,

[440] *See supra* section III.A.2.c.i for a discussion of the proposed definition of a central bank for the purposes of the rule.

[441] *See supra* section III.A.2.c.i for a discussion of the proposed definition of sovereign entity and international financial institution. *See also supra* note 160.

[442] *See supra* section III.A.2.c.i 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. *See also* section IV.B.2, *supra.*

[443] *See id.* for a discussion of the Commission's belief in the principles of international comity.

[444] *See supra* note 203.

[445] DTCC October 2021 White Paper, *supra* note 203, at 5–6.

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 proposed amendments to Rule 17Ad–22(e)(6)(i) would 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 would 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 proposed 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 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 can be netted against the direct participant's position vis-à-vis other dealers, which is not currently the case.[446]

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.[447] 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.

ii. 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 proposed 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.[448] 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.[449] 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 proposed rule would require 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);[450] 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, and on either side (lending or borrowing) of the transaction. At present, it appears that FICC direct members may be able to decline to submit a trade for central clearing at their discretion.[451] 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 not be able to access central clearing under the current practice. The proposed rule would require FICC to create new policies and procedures to facilitate access to clearing for these participants.

In addition, the proposal would require 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 addressed at the most senior levels of the governance framework. The annual review ensures that such policies and procedures be reviewed periodically and potentially updated to address any changes in market conditions.

c. Proposed Amendments to Rules 15c3–3 and 15c3–3a

The proposed rules 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 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 Membership Proposal would result

[446] Chicago Fed Insights, *supra* note 204, at 3.

[447] 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).

[448] *See* FIA–PTG Whitepaper, *supra* note 220.

[449] *See id.* at 7.

[450] Accessing clearing through another party may lower costs, but market participants have commented that there may still be residual exposure should that counterparty default after the CCA has performed on its obligations.

[451] *See supra* section IV.B.3.

in corresponding increases in the need to use broker-dealers' cash and securities to meet these requirements.

The proposed amendment to Rule 15c3–3a would 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 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 proposed amendment would allow 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.

2. Costs

The Commission has, where practicable, attempted to quantify the economic effects it expects may result from this proposal. In some cases, however, data needed to quantify these economic effects are not currently available or depends on the particular changes made to the U.S. Treasury securities CCA policies and procedures. As noted below, the Commission is unable to quantify certain economic effects and solicits comment, including estimates and data from interested parties, which could help inform the estimates of the economic effects of the proposal.

a. Costs to FICC of the Membership Proposal

The Commission believes that the direct costs of this proposal to the U.S. Treasury securities CCA, which are mostly in the form of new policies and procedures, are likely to be modest. This is because all but one of these proposals require the CCA to make certain changes to its policies and procedures. The other proposal 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, subject to the conditions discussed above.

Proposed Rule 17Ad–22(e)(18)(iv) would require a U.S. Treasury securities CCA to establish, implement, maintain, and enforce written policies and procedures, as discussed above.[452] 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 the proposed Rule 17Ad–22(e)(18)(iv) may require a covered clearing agency to make substantial changes to its policies and procedures. The proposed rule amendment contains similar provisions to existing FICC rules, but would also impose additional requirements that do not appear in existing Rule 17Ad–22.[453] As a result, the Commission believes that a U.S. Treasury securities CCA would incur burdens of reviewing and updating existing policies and procedures in order to comply with the provisions of proposed Rule 17Ad–22(e)(18)(iv) and, in some cases, may need to create new policies and procedures.

The Commission preliminarily estimates that U.S. Treasury securities CCAs would incur an aggregate one-time cost of approximately $207,000 to create new policies and procedures.[454] [455] The proposed rule would also require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. The Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad–22(e)(18)(iv) would impose an aggregate ongoing cost on covered clearing agencies of approximately $61,000 per year.[456]

i. Costs Attendant to an Increase in CCLF

This proposal will likely result in a significant increase in the volume of U.S. Treasury securities transactions submitted to clearing. As pointed out by the G–30 report, 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.[457] This is because net long positions generate liquidity obligations for FICC because, 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 proposed rule could increase FICC's credit and liquidity exposure to its largest members including those members acting as sponsors of non-members. FICC is obligated by Commission rule to maintain liquidity resources to enable it to complete settlement in the event of a clearing member default of a Member.[458] 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.[459]

As reported in the CPMI–IOSCO disclosure by FICC for Q2 of 2021, the combined liquidity commitment by clearing members to the FICC's Capped Contingent Liquidity Facility (CCLF) was $82.5 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

[452] See supra section III.A.4 for a discussion of the requirement that a U.S. Treasury securities CCA establish 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 supra section III.B.2 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.

[453] See supra note 34 and accompanying text (discussing current FICC rules).

[454] 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.

[455] 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 × 2 respondent clearing agencies = $206,560. *See infra* section V.A.

[456] This figure was calculated as follows: Compliance Attorney for 25 hours (at $518 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 × 2 respondent clearing agencies = $60,580. *See infra* section V.A.

[457] G–30 Report, *supra* note 5, at 14.

[458] *See supra* section IV.B.3.

[459] FICC Disclosure Framework 2021 at 88, *available at https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf.*

size from $82.5B to $108B.[460] Commitments by bank-affiliated dealers to the CCLF count against regulatory liquidity requirements, including the Liquidity Coverage Ratio (LCR).[461] The Commission understands that 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.

ii. Costs of the Membership Proposal in Terms of Increased Margining for Existing FICC Members

As discussed above, the Commission recognizes that the proposal 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 the proposal. 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.[462] 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.[463] As described in section IV.C.1 *supra,* this mitigant is likely to be especially significant in the case of IDB members. Also, substantially mitigating the costs for clearing members is the ability to rehypothecate customer margin, as described in section IV.C.2.d *infra.*

b. Costs to Non-FICC Members as a Result of the Membership Proposal

The Membership Proposal would require that all repo transactions with a direct participant be centrally cleared and that certain cash transactions with a direct participant to be centrally cleared. These costs will depend on the policies and procedures developed by the CCA, as discussed in sections IV.C.2.a *infra* and IV.C.2.d *supra.*

As stated above, the Commission believes that these proposed 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 current proposed amendments would be subject to certain transaction, position, and other fees as determined by the U.S. Treasury securities CCA.[464]

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 collateral. 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 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 would be required to be centrally cleared could incur direct costs for arranging 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. In this case, clearing risks leakage of information. Moreover, 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.[465] 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 outright 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, would significantly mitigate these costs.

Some participants may not currently post collateral 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 collateral. An institutional investor self-managing its account would instruct its custodian to post collateral with the CCA on the execution date, and post a transaction in its internal accounting system showing the movement of collateral. The day after trade execution, the investor would oversee the return of collateral 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 collateral.

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 and to the extent that the margin was not simply included in the price quoted for the trade. This cost of margining is analogous to that borne by CCA members and is discussed further above.

As a result of the proposed rule, a potential cost to money market fund participants that would 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

[460] *See supra* section IV.B.3.

[461] 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.

[462] *See supra* note 106.

[463] *See supra* section IV.C.1 for a discussion of the benefits of multilateral netting expected to result from higher volumes of centrally cleared transactions.

[464] The fee structure for FICC is described in its rulebook. *See* FICC Rules, *supra* note 47, at 307.

[465] *See* FIA–PTG Whitepaper, *supra* note 220 (for a description of different client clearing models).

distinguish the CCA from a conventional counterparty.

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.'' [466]

As discussed previously, currently only FICC provides CCP services for U.S. Treasury securities transactions, including outright cash transactions and repos.[467] 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 important financial market utility in 2012,[468] which subjects it to heightened risk management requirements and additional regulatory supervision, by both its primary regulator and the Federal Reserve Board of Governors.[469]

c. Other Changes to Covered Clearing Agency Standards

i. Netting and Margin Practices for House and Customer Accounts

The proposed 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 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.[470] The proposed rule amendment contains similar provisions to existing FICC rules, specifically with respect to its Sponsored Member program, but would 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 would incur burdens of reviewing and updating existing policies and procedures in order to comply with the proposed amendments to Rule 17Ad–22(e)(6) and, in some cases, may need to create new policies and procedures.[471]

The Commission preliminarily estimates that U.S. Treasury securities CCAs would incur an aggregate one-time cost of approximately $106,850 to create new policies and procedures.[472] The proposed rule would also require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. The Commission preliminarily estimates that the ongoing activities required by proposed amendments to Rule 17Ad–22(e)(6) would impose an aggregate ongoing cost on covered clearing agencies of approximately $60,580 per year.[473]

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

The proposed Rule 17Ad–22(e)(18)(iv)(C) would require 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 proposed rule would require 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 would incur burdens of reviewing and updating existing policies and procedures and would need to create new policies and procedures in order to comply with the provisions of proposed 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.[474]

d. Proposed Amendments to Rules 15c3–3 and 15c3–3a

The proposed amendment to Rule 15c3–3a would 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 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 proposed amendment would allow 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 proposed rule does not require that the broker-dealer does so.

3. Effect on Efficiency, Competition, and Capital Formation

a. Efficiency

i. Price Transparency

As mentioned in section II.A.1 *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 multiple points of entry''.[475] As a result, pre-

[466] *See supra* note 11.

[467] *See supra* section I.C.

[468] *See* note 17 *supra.*

[469] *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.'' Clearing Agency Standards Proposing Release, *supra* note 7, 76 FR at 14474; *see also* 12 U.S.C. 5462(9), 5463(a)(2).

[470] *See supra* section III.B.1.

[471] *See supra* note 62 and accompanying text (discussing existing FICC rules for sponsored member program).

[472] 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 × 2 respondent clearing agencies = $106,850. *See infra* section V.B.

[473] 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 × 2 respondent clearing agencies = $60,580. *See infra* section V.B.

[474] *See supra* section IV.C.2.

[475] Mauren O'Hara and Mao Ye, ''*Is Market Fragmentation Harming Market Quality,*'' 100 J. Fin. Econ. 459 (2011), *available at https://doi.org/10.1016/j.jfineco.2011.02.006.*

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;[476] and second, the accessibility of central clearing could promote all-to-all trading as previously mentioned in section III.A.3 *supra,* which would reduce the obstacles to information flow that come from fragmentation.[477]

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 proposed amendment to Rule 15c3–3a would 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 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 proposed amendment would allow 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 end clients, 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.[478] Similarly, decreased counterparty credit risk—and potentially lower costs for intermediation—could result in narrower spreads, thereby enhancing market quality.[479] While estimating this quantitatively is difficult, research has demonstrated lower costs associated with central clearing in other settings.[480] Moreover, increased accessibility of central clearing in U.S. Treasury securities markets could support all-to-all trading, which would further improve competitive pricing, market structure and resiliency.[481]

The U.S. Treasury securities intermediation business is also capital-intensive, due to strict regulatory requirements around capital and the sheer size of the U.S. Treasury securities markets. These requirements represent a barrier to entry to new participants. The proposed amendments to Rule 15c3–3a, which would 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, in addition to the natural capital efficiencies of margin offsetting provided by clearing, would provide some capital relief for smaller broker-dealers. This may enable them to better compete in this market or enter the market altogether.

With respect to the market for U.S. Treasury securities clearing services, currently there is a single provider of central clearing. The proposed amendments would 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.[482] [483] 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.[484] Market power may also affect the allocation of benefits and costs flowing from these proposed rules, namely the extent to which these benefits and costs are passed through by FICC to participants.[485] 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.

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.

c. Capital Formation

The proposed rule may encourage private-sector capital formation. U.S. Treasury securities form a benchmark

[476] FIA–PTG Whitepaper, *supra* note 220.

[477] *See supra* note 190.

[478] *See* G–30 Report, *supra* note 5, at 13.

[479] *See id.*

[480] *See* Y.C. Loon and Z.K. Zhong, *The Impact of Central Clearing on Counterparty Risk, Liquidity, and Trading: Evidence from the Credit Default Swap Market,* 112(1) JOURNAL OF FINANCIAL ECONOMICS 91–115 (Apr. 2014).

[481] *See* IAWG Report, *supra* note 4, at 30; Duffie, *supra* note 186, at 16; G–30 Report, *supra* note 5, at 13.

[482] *See* Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions (''CPSS–IOSCO''), Principles for Financial Market Infrastructures (Apr. 16, 2012), *available at http://www.bis.org/publ/cpss101a.pdf* (''PFMI Report'').

[483] *See generally* Nadia Linciano, Giovanni Siciliano & Gianfranco Trovatore, *The Clearing and Settlement Industry: Structure Competition and Regulatory Issues* (Italian Secs. & Exch. Comm'n Research Paper 58, May 2005), *available at http://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).

[484] *See* CCA Standards Proposing Release, *supra* note 7.

[485] For a discussion of cost pass-through, including when there lacks competition, see for example, UK Competition and Markets Authority, Cost pass-through: theory, measurement and policy implications (June 17, 2014), *available at https://www.gov.uk/government/publications/cost-pass-through-theory-measurement-and-policy-implications.*

for fixed income and even equity rates of return, and the proposed rule could lower the cost of capital for private-sector issuers.[486] 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 proposed 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 US taxpayers.[487]

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 Trades With Non-Members for Central Clearing

One alternative would be to narrow the scope of the Membership Proposal 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 would include (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.[488] This alternative differs from the proposal above 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 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.[489]

As discussed in section IV.C.1.a *supra,* 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.[490] 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,'' [491] 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 noted above, 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. 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.[492]

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.[493] 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 above, funds that are leveraged present potential risk to a U.S. Treasury securities CCA.[494] As a result of not including transactions with hedge funds and levered accounts, the Commission believes that benefits of the rule with respect to financial stability, margin offsetting and visibility of risk would be curtailed.

This alternative could also include within the definition of eligible secondary market transactions 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 would increase the benefits discussed above associated with an increased proportion of transactions being centrally cleared.[495] 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.[496]

2. Require U.S. Treasury Securities CCAs To Have Policies and Procedures Requiring the Submission of All Repurchase Agreements With No Change to Requirements for the Submission of Cash Transactions

The Commission could exclude the cash U.S. Treasury securities market from the proposed rule and instead only require 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.

[486] 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).

[487] *See* Arvind Krishnamurthy & Annette Vissing-Jorgensen, *The Aggregate Demand for Treasury Debt,* 120 J. Pol. Econ. (Apr. 2012).

[488] Such direct participants are referred to in this section and the alternatives below as ''IDBs''. *See supra* section III.A.2.b (IDB Transactions).

[489] *See supra* section III.A.2.b for a discussion of cash transactions included in the definition of eligible transactions.

[490] *See* TMPG White Paper, *supra* note 20 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.'').

[491] *See* TMPG White Paper, *supra* note 21, at 27.

[492] *See* TMPG White Paper, *supra* note 21, at 32.

[493] *See id.*

[494] *See supra* section IV.C.1.III(b). *See also* note 145.

[495] *See supra* section IV.A for a discussion of the benefits associated with increased central clearing.

[496] *See supra* section IV.C.1.a.III(b) for a discussion of the familiarity of many registered brokers with methods of central clearing of U.S. Treasury securities transactions. *See also* section IV.C.2.b for a discussion of the costs to non-FICC members, including the entities included within this alternative, of the Membership proposal.

The Commission understands that there is a likely benefit of additional balance sheet capacity that flow 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 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 recognize the risk-reducing effects of multilateral netting of trades that CCP clearing accomplishes.[497]

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 sample 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 that 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 proposal 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. Moreover, certain leveraged and opportunistic market participants that are net contributors of risk to the U.S. Treasury security market, such as hedge funds and leveraged accounts in broker-dealers, would be exempt from the clearing requirement under this alternative.

[497] *See* IAWG Report at 30, *supra* note 4; Liang & Parkinson, *supra* note 32, at 9; Duffie, *supra* note 186, at 16–17.

3. Include All Cash Transactions Within the Scope of the Membership Proposal With Exceptions for Central Banks, Sovereign Entities, International Financial Institutions, and Natural Persons

The Commission could require 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 (including those included in the Membership Proposal) except for those that fall within one of the aforementioned exceptions.

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 [498] on clearing benefits. 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.

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 marker 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 including these participants in the Membership Proposal are likely higher than those of participants included in the proposal and the benefits smaller.

[498] Michael Fleming & Frank Keane, Staff Report No. 964: *Netting Efficiencies of Marketwide Central Clearing, Federal Reserve Bank of New York* (Apr. 2021), *available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf.*

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

The Commission could, as an alternative to the selected policy choice, only amend Rules 15c3–3, 17Ad–22(e)(6)(i), and 17Ad–22(e)(18)(iv)(C). This alternative would not include implementing changes related to the Membership Proposal, as set forth in Proposed Rule 17Ad–22(e)(18)(iv)(A) and (B).

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 15c3–3a, 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 section 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.

Nonetheless, the Commission believes that this alternative is not preferable to the proposal. Although this alternative may result in additional central clearing of U.S Treasury security trades by reducing some of the impediments to central clearing, the benefits are likely to be less in the absence of the membership proposal. As previously explained, the benefits of clearing are proportional to the number of participants submitting their trades to the CCP: the higher the number of participants, the greater the benefits of central clearing. Absent a coordinated effort that induces participants to incur short-term, private costs in order to obtain a larger, longer-term collective benefit, which the Membership Proposal provides, the Commission believes that the number of participants that will voluntarily make the necessary changes to clear their transactions would be lower under this alternative.

E. Request for Comment

The Commission requests comment on all aspects of this initial economic analysis, including the potential benefits and costs, including all effects on efficiency, competition, and capital formation; and reasonable alternatives to the proposal. We request and encourage any interested person to submit comments regarding the proposal, our analysis of the potential effects of the proposal, and other matters that may have an effect on the proposal. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposal. We also are interested in comments on the qualitative benefits and costs the Commission has identified and any benefits and costs the Commission may have overlooked. In addition to our general request for comments on the economic analysis associated with the proposal, the Commission requests specific comment on certain aspects of the proposal:

Baseline

- The Commission seeks input and supporting data on the size of the U.S. Treasury securities market as a whole and additional data on the proportion of cash and repo U.S. Treasury transactions that U.S. Treasury securities CCA members clear and settle with the CCP and those that they clear and settle bilaterally. In particular, what proportion of dealer to client and dealer-to-dealer transactions are cleared?
- The Commission seeks data on U.S. Treasury securities transactions executed by banks and other institutions that are not members of FINRA and therefore do not have a regulatory requirement to report their executed trades to TRACE.
- Does the current menu of clearing offerings, including Sponsored Clearing, provide enough options for individuals and institutions who want to participate in the U.S. Treasury Securities market?
- What role does the market for ''when-issued'' U.S. Treasury securities that trade prior to and on the day of the auction currently play in risk mitigation and hedging strategies of primary dealers? What role does this market play in price discovery?
- Should the Commission include in the scope of eligible secondary market transactions when-issued transactions in U.S. Treasury securities that take place prior to and on the day of the auction for those securities? What are the potential benefits and costs of including in the scope of eligible secondary market transaction pre-auction and auction day when-issued transactions along with post-auction when-issued transactions? Is there a greater contagion risk from fails-to-deliver if the proposal's scope of eligible secondary market transactions does not include ''when-issued'' U.S. Treasury securities transactions that take place prior to and on the day of the auction?

Economic Effects, Including Impact of Efficiency, Competition, and Capital Formation

- Are there any additional costs and benefits associated with the proposed amendments that should be included in the analysis? What additional materials and data should be included for estimating these costs and benefits?
- Does the economic analysis capture the relative risks posed by various types of market participants to the functioning of U.S. Treasury market?
- Will U.S. Treasury securities CCAs face additional costs to managing the risk of higher volumes and increased heterogeneity of entities that will result from the Membership proposal?
- Who requests sponsored membership? Is it the asset owner or the investment manager? If the asset owner, how does the adviser support sponsored membership with multiple sponsoring members? If the investment manager sets this up, how does the asset owner change investment managers and is more lead time required to set up a new account with a new investment manager? Who pays for all this and what does it cost?
- What are the operational costs to asset owners and to advisers to centrally clear cash U.S. Treasury securities? Will there be benefits to asset owners or to advisers? Will operational risk for asset owners or adviser increase or decrease and why?
- What are the operational costs to asset owners and to advisers to centrally clear repos? Will there be benefits to asset owners or to advisers? Will operational risk for asset owners or adviser increase or decrease and why?
- What would be the potential impact to FICC's CCLF and its participants' obligations under that requirement? What costs may participants incur as a result of changes to their obligations under that requirement? Would these costs vary depending on whether or not the entity was affiliated with a bank? Would they vary based on the size of the entity?
- Market participants in the secondary market for U.S Treasury securities that would be required to be centrally cleared could incur direct costs for arranging legal agreements with every potential counterparty. Depending on the customer there may be a large number of such arrangements. How much does it cost to arrange such legal agreements and how many such agreements might a market participant need to arrange?
- Given the potential effects on competition of the proposal if adopted, should FICC be required to review its fee structure as part of its review required by Rule 17Ad–22(e)(18)(iv)? Within what time frame should this review take place?
- Are there any additional impacts on dealer competition that should be

included in the analysis? The Commission seeks information and data on dealer concentration over time. In particular, have there been any changes in dealer concentration in recent years?

Reasonable Alternatives

- The Commission seeks input on the costs, benefits and feasibility of the alternatives to the proposed rule described above. Are there any additional benefits or costs that should be included in the analysis of the reasonable alternatives considered?

V. Paperwork Reduction Act

A. Proposed Changes to Covered Clearing Agency Standards

The proposed amendments to Rule 17Ad–22(e) contain ''collection of information'' requirements within the meaning of the PRA.[499] The Commission is submitting the proposed collection of information to the Office of Management and Budget (''OMB'') for review in accordance with the PRA. For the proposed amendments to Rule 17Ad–22(e), the title of the existing information collection is ''Clearing Agency Standards for Operation and Governance'' (OMB Control No. 3235–0695), and that collection would be revised by the changes in this proposal, if adopted. 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 proposal the Commission has assumed two respondents.

A. Proposed 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.[500]

The proposed amendments to Rule 17Ad–22(e)(6) would require a Treasury securities CCA to establish, implement, maintain, and enforce written policies and procedures. The proposed rule amendment contains similar provisions to existing FICC rules, specifically with respect to its Sponsored Member program, but would also impose additional requirements that do not appear in existing Rule 17Ad–22. As a result, the Commission preliminarily believes that a respondent Treasury securities CCA would incur burdens of reviewing and updating existing policies and procedures in order to comply with the proposed amendments to Rule 17Ad–22(e)(6) and, in some cases, may need to create new policies and procedures.[501] The Commission preliminarily believes that the estimated PRA burdens for the proposed amendments 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,[502] the Commission preliminarily estimates that respondent Treasury securities CCAs would incur an aggregate one-time burden of approximately 258 hours to review existing policies and procedures and create new policies and procedures.[503]

Proposed Rule 17Ad–22(e)(6) would impose ongoing burdens on a respondent Treasury securities CCA. The proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed 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,[504] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad–22(e)(6) would impose an aggregate annual burden on respondent clearing agencies of 182 hours.[505]

Name of information collection	Type of burden	Number of respondents	Initial burden per entity (hours)	Aggregate initial burden (hours)	Ongoing burden per entity (hours)	Aggregate ongoing burden (hours)
17Ad–22	Recordkeeping	2	129	258	91	182

B. Proposed Amendment to Rule 17Ad–22(e)(18)(iv)

The purpose of the collection of information under proposed 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

[499] *See* 44 U.S.C. 3501 *et seq.*

[500] *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).

[501] *See supra* note 126 and accompanying text (discussing existing FICC rules for sponsored member program).

[502] *See* CCA Standards Adopting Release, *supra* note 26, 81 FR at 70895–97 (discussing Rules 17Ad–22(e)(13), (15), and (18)). Although the proposed rule amendment is with respect to Rule 17Ad–22(e)(6), the Commission believes that these Rules present the best overall comparison to the current proposed rule amendment, in light of the nature of the changes needed to implement the proposal here and what was proposed in the Covered Clearing Agency Standards.

[503] 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 × 2 respondent clearing agencies = 258 hours.

[504] *See* CCA Standards Adopting Release, *supra* note 26, 81 FR at 70893 and 70895–96 (discussing Rules 17Ad–22(e)(6) and (13)).

[505] This figure was calculated as follows: (Compliance Attorney for 25 hours + Business Risk Analyst for 40 hours + Senior Risk Management Specialist for 20 hours) = 80 hours × 2 respondent clearing agencies = 160 hours.

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 proposal 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 to be submitted. Finally, the purpose of the proposal 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.[506]

Proposed Rule 17Ad–22(e)(18)(iv) would require 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 preliminarily believes that the estimated PRA burdens for proposed 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 proposed rule amendment contains similar provisions to existing rules, but would also impose additional requirements that do not appear in existing Rule 17Ad–22.[507] As a result, the Commission preliminarily 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 proposed 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 the Covered Clearing Agency Standards where the Commission anticipated similar burdens,[508] the Commission preliminarily estimates that respondent Treasury securities CCAs would incur an aggregate one-time burden of approximately 520 hours to review existing policies and procedures and create new policies and procedures.[509]

Proposed Rule 17Ad–22(e)(18)(iv) would impose ongoing burdens on a respondent Treasury securities CCA. The proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed 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,[510] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad–22(e)(18)(iv) would impose an aggregate ongoing burden on respondent clearing agencies of 170 hours.[511]

Name of information collection	Type of burden	Number of respondents	Initial burden per entity (hours)	Aggregate initial burden (hours)	Ongoing burden per entity (hours)	Aggregate ongoing burden (hours)
17Ad–22(e)	Recordkeeping	2	260	520	80	170

C. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

1. Evaluate whether the proposed collections of information are necessary for the proper performance of the Commission's functions, including whether the information shall have practical utility;

2. Evaluate the accuracy of the Commission's estimates of the burdens of the proposed collections of information;

3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;

4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and

5. Evaluate whether the proposed rules and rule amendments would have any effects on any other collection of information not previously identified in this section.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and

[506] *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).

[507] *See supra* note 34 and accompanying text (discussing current FICC rules).

[508] *See* CCA Standards Adopting Release, *supra* note 26, 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 current proposed rule amendment, in light of the nature of the changes proposed. Although the proposed 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 proposed requirement and the changes necessary to establish and implement that requirement, as compared to the current Commission rules and U.S. Treasury securities CCA rules.

[509] 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 × 2 respondent clearing agencies = 520 hours.

[510] *See supra* note 502 above (discussing relevant aspects of the Covered Clearing Agency Standards).

[511] 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 × 2 respondent clearing agencies = 170 hours.

Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File Number S7–23–22. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7–23–22 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street NE, Washington, DC 20549–2736. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

B. Broker-Dealers

The proposed 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 amendment.

VI. Small Business Regulatory Enforcement Fairness Act

Under the Small Business Regulatory Enforcement Fairness Act of 1996,[512] a rule is ''major'' if it has resulted, or is likely to result in: an annual effect on the economy of $100 million or more; a major increase in costs or prices for consumers or individual industries; or significant adverse effects on competition, investment, or innovation. The Commission requests comment on whether the proposed rules and rule amendments would be a ''major'' rule for purposes of the Small Business Regulatory Enforcement Fairness Act. In addition, the Commission solicits comment and empirical data on: the potential effect on the U.S. economy on annual basis; any potential increase in costs or prices for consumer or individual industries; and any potential effect on competition, investment, or innovation.

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'') requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.[513] Section 603(a) of the Administrative Procedure Act,[514] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on ''small entities.'' [515] 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.[516]

A. Clearing Agencies

The proposed 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.[517] 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.[518]

Based on the Commission's existing information about the clearing agencies currently registered with the Commission, the Commission preliminarily 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 preliminarily does not believe that any such entities would be ''small entities'' as defined in Exchange Act Rule 0–10.[519] In any case, clearing agencies can only become subject to the new requirements under proposed Rule 17Ad–22(e) should they meet the definition of a covered clearing agency, as described above. Accordingly, the Commission preliminarily believes that any such registered clearing agencies will exceed the thresholds for ''small entities'' set forth in Exchange Act Rule 0–10.

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.[520] 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 proposed rule amendment to Rule 15c3–3a would permit margin required and on deposit at a covered clearing agency providing central counterparty services for Treasury securities to be included by broker-dealers as a debit in the customer or PAB reserve formula. Only carrying broker-dealers will be impacted by the proposed rule amendment. This is because only carrying broker-dealers are required to maintain a customer or PAB reserve account and may collect customer margin.

Based on FOCUS Report data, the Commission estimates that as of December 31, 2021, there were approximately 744 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-

[512] Pubic Law 104–121, Title II, 110 Stat. 857 (1996).

[513] *See* 5 U.S.C. 601 *et seq.*

[514] 5 U.S.C. 603(a).

[515] 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 proposed rulemaking, are set forth in Rule 0–10, 17 CFR 240.0–10.

[516] *See* 5 U.S.C. 605(b).

[517] 17 CFR 240.17AD–22(a)(5).

[518] *See* 17 CFR 240.0–10(d).

[519] *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.

[520] *See* 17 CFR 240.0–10(c).

dealers (*i.e.,* can carry customer or PAB margin accounts and extend credit). However, based on December 31, 2021, 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 proposed rule amendment likely would not apply to them. Therefore, while the Commission believes that some small broker-dealers could be affected by the proposed 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 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 Commission requests comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including clearing agencies and broker-dealers, and provide empirical data to support the extent of the impact.

Statutory Authority

The Commission is proposing amendments to Rule 17Ad–22 under the Commission's rulemaking authority set forth in section 17A of the Exchange Act, 15 U.S.C. 78q–1. 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 proposing to amend § 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 proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read, in part, 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, 78*l,* 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 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.

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Section 240.17Ad–22 is also issued under 12 U.S.C. 5461 *et seq.*

* * * * *

■ 2. Revise § 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.

§ 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' U.S. Treasury 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 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 or dealer that are cleared, settled, and novated by the qualified clearing agency.

(b) Item 15 will apply only if the cash and U.S. Treasury securities required and on deposit at the qualified clearing agency:

(1) Are, in the case of cash, owed by the broker or dealer to the customer of the broker or dealer or, in the case of U.S. Treasury securities, held in custody by the broker or dealer for the customer of the broker or dealer and 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;

(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 and U.S. Treasury securities used to margin the U.S. Treasury securities positions of the customers of the broker or dealer be held in an account of the broker or dealer at the qualified clearing agency that is segregated from any other account of the broker or dealer at the qualified clearing agency and that is:

(A) Used exclusively to clear, settle, novate, and margin U.S. Treasury securities transactions of the customers of the broker or dealer;

(B) Designated ''Special Clearing Account for the Exclusive Benefit of the Customers of [name of broker or dealer]'';

(C) Subject to a written notice of the qualified clearing agency provided to and retained by the broker or dealer that the cash and U.S. Treasury securities in the account are being held by the qualified clearing agency for the exclusive benefit of the customers of the broker or dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker or dealer or any other clearing member at the qualified clearing agency; and

(D) Subject to a written contract between the broker or dealer and the qualified clearing agency which provides that the cash and U.S. Treasury securities in the account are not available to cover claims arising from the broker or dealer or any other clearing member defaulting on an obligation to the qualified clearing agency or subject to any other right, charge, security interest, lien, or claim of any kind in favor of the qualified clearing agency or any person claiming through the qualified clearing agency, except a right, charge, security interest, lien, or claim resulting from a cleared U.S. Treasury securities transaction of a customer of the broker or dealer effected in the account;

(iv) Rules requiring the qualified clearing agency to hold the customer cash and U.S. Treasury 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 and U.S. Treasury 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 and U.S. Treasury 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 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; and

(v) Rules requiring systems, controls, policies, and procedures to return cash and U.S. Treasury 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 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; 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 customer cash or U.S. Treasury 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.

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. Amend § 240.17Ad-22 by:

■ a. In paragraph (a):

■ i. Removing the second-level paragraph designations, and

■ ii. Inserting in alphabetical order definitions for ''Central bank'', ''Eligible secondary market transaction'', ''International financial institution'', ''Sovereign entity'', and ''U.S. Treasury security''.

■ b. Revising paragraphs (e)(6)(i) and (e)(18).

The revisions and additions read as follows:

§ 240.17Ad-22 Standards for clearing agencies.

(a) * * *

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;

(B) Registered broker-dealer, government securities broker, or government securities dealer;

(C) A hedge fund, that is, any private fund (other than a securitized asset fund):

(*1*) 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);

(*2*) 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

(*3*) 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); or

(D) 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; 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.

* * * * *

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.

* * * * *

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 board of directors of such covered clearing agency reviews annually.

* * * * *

By the Commission.

Dated: September 14, 2022.

Vanessa A. Countryman,

Secretary.

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