May 7, 2024

SUBMITTED VIA AGENCY WEBSITE

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: Release No. 34-99710; File No. SR-FICC-2024-003; Notice of Filing of Proposed Rule Change to Adopt a Minimum Margin Amount at GSD

Dear Ms. Countryman,

The Independent Dealer and Trader Association (IDTA) applauds DTCC's Fixed Income Clearing Corp. (FICC) division in their efforts to make the Treasury market more stable and minimize systemic risk. However, we urge changes to this proposal to eliminate the negative impact on market liquidity and concentration and to make the changes less punitive to middle market broker-dealers.

Background

When the Federal Reserve began tightening interest rates in March 2022, the Treasury market experienced increased volatility. Most of this volatility occurred in the short-end of the yield curve, the area most affected by changes in short-term rates. When FICC back-tested their VaR model, they found they were slightly under their model confidence level, based on the SEC requirement. According to FICC:

> *. . . the impact study also indicated that if the proposed rule changes had been in place, the VaR model back testing coverage would have increased from approximately 98.86% to 99.46% during the Impact Study Period . . . overall margin back testing coverage would have increased from approximately 98.87% to 99.33% during the Impact Study Period.*[1]

FICC strives to maintain a 99% confidence level in its risk model. The actual margin that FICC collected from members fell to a 98.87% confidence level. That means, they estimate, only

[1] Proposed Rule Change to Adopt a Minimum Margin Amount at GSD, Exchange Act Release No. 34-99710 at 23 (Mar. 11, 2024) (as amended), https://www.sec.gov/files/rules/sro/ficc/2024/34-99710.pdf.

98.87% of the time, the amount of margin was sufficient to cover member defaults. FICC determined they need a new methodology to increase margin collection by .13% (about one eight of a percent). In response, FICC proposes to introduce a "Minimum Margin Amount" (MMA) charge to its members. FICC will compare their current VaR model margin requirement to the new MMA model margin requirement and use the greater of the two. As part of the MMA proposal, FICC conducted an impact study on members' margin portfolios for a period between July 1, 2021 to June 30, 2023.[2] According to the impact study, the average MMA would increase the SOD VaR charge by 17.69%. On top of the MMA proposal, FICC is able to levy a "special charge." On April 12, 2024, FICC published a notice that it would collect a 3-day special charge around certain volatile market events equal to 10% of the netting member's VaR charge.[3]

The new MMA requirement was submitted to the SEC for review at the end of February 2024 and is awaiting final approval. The IDTA believes the SEC should reject this proposal. Though the concept of a 99.00% confidence level is sound, it must be implemented with a precise VaR calculation. The submission to the SEC has many flaws. If implemented, the MMA will negatively impact Treasury market liquidity. Just a few months ago the SEC approved the new central clearing mandate that was intended to enhance Treasury market liquidity, the FICC's new MMA would reduce it.

FICC VaR Margin

Over the past several years, FICC was aware its VaR model did not capture the full 99% confidence level.[4] During this period of time, FICC introduced several additional margin charges which may have been designed to plug the gap.

In 2021, FICC implemented a rule imposing a flat 0.125% haircut on securities maturing between 1 day and 6 months, and 0.25% haircut on securities maturing between 6 months and 1 year.[5] A "special charge"[6] and a "backtesting charge"[7] were both implemented as well. These margin charges were designed to plug the 0.13% gap in the VaR model. However, the current FICC VaR margin does not take into account whether the participant firm is a systemically important financial institution (SIFI), nor does it take into account the degree of difficulty or lack thereof of unwinding the positions of non-SIFIs.

One-size-fits-all risk models do not work well and tend to distort the marketplace. For example, after the Treasury Bill VaR change, six-month Treasury Bills and 1-month Treasury Bills were charged the same margin percentage, despite the fact that a one-month Bill is six times <u>less</u> risky than a six-month Bill. While FICC's intention to meet the 99% confidence model is noble, the use of blunt, unspecific rules may often lead to margin increases beyond reasonable VaR charges that do not accurately reflect the risk mitigated.

---

[2] *Id.* at 22.
[3] Depository Trust & Clearing Corporation, Collection of Special Charge at Volatile Market Events (Apr. 12, 2024), https://www.dtcc.com/-/media/Files/pdf/2024/4/12/GOV1681-24---Special-Charge-at-Volatile-Market-Events.pdf.
[4] *Supra* note 1 at 26.
[5] Order Approving Proposed Rule Change to Change the Treatment of Short-Term Treasuries, Exchange Act Release No. 34-93234 (Oct. 1, 2021), https://www.sec.gov/files/rules/sro/ficc/2021/34-93234.pdf.
[6] Proposed Rule Change to Modify the FICC Government Securities Division Rulebook, Exchange Act Release No. 34-92340 (July 7, 2021), https://www.sec.gov/rules/sro/ficc/2021/34-92340.pdf.
[7] Order Granting Approval of Proposed Rule Changes To Describe the Backtesting Charge

Problems With The MMA

The IDTA feels that the impact study contains several flaws which renders it inaccurate and imprecise. Furthermore, there exist several flaws in the MMA model as it currently exists which make any proposed increase problematic.

1. Misleading Period of Time **-** When determining the "average" estimated increase in margin, the period of time used in the study was much longer than the period of increased volatility. The study took place from July 1, 2021 to June 30, 2023, approximately two years, while the period of increased volatility occurred in sustained fashion from September 2022 to June 2023, about 9 months, or less than half of the study period (though there were some spikes in June of 2022 of limited duration). When calculating averages, using a two-year period instead of a nine-month period means the average is diluted. Mathematically, by increasing the denominator, it decreases the average 2.66 times. A $26.66 million "average" margin increase becomes a $10 million increase with the increased duration. While SIFIs would have no such problems with the higher capital requirements since they have much higher nominal capital positions, that average increase difference matters disproportionately for independent middle-market broker dealers. Furthermore, it is often difficult for regulators to consider all of the risks a SIFI's nominal capital actually underwrites.

2. Capital Planning in Practice – FICC expresses the increase in margin requirements in terms of long-term average, but broker-dealers do not plan for capitalization based on "average" capital usage.[8] A broker dealer must have sufficient capital to meet at least the largest margin call—and generally more. The FICC study is misleading because members must have sufficient capital to meet their highest possible margin call.

3. Unrepresentative Data – In the SEC rule submission, FICC used the following examples to illustrate the impact of the rule change on members:

   > *The largest average percentage increase in SOD VaR Charge for any Member would have been approximately 66.88%, or $97,051 (0.21% of the Member's average Net Capital)*[9]

   FICC tried to show the member with the largest relative margin increase and demonstrate an immaterial increase. However, this member's increase was only $97,051. Any FICC member with an FICC margin requirement of only $145,112[10] is not a relevant, active player in the Treasury market. This example does not represent the true impact on non-SIFIs.

   Here is the other example:

   > *The largest average dollar increase in SOD VaR Charge for any Member would have been approximately $268.35 million (0.34% of the Member's average Net Capital), or 19.05% …*

   FICC stresses the small increase relative to the members' net capital (0.34% here and 0.21% in the previous example). When presenting the largest dollar change, which is clearly from a member with a large net capital base, it is not representative of the membership at large, and

[8] Unless, of course, FICC changes their margin policy to charge "average margin" usage over a period of time.
[9] *Supra* note 1.
[10] $97,051/.6688 = $145,112

certainly not of the middle market firms. For example, the average percentage increase in SOD VaR of IDTA members is 14.59%, or $8.75 million. And the average percentage increase for the top 100 most stressful days in terms of margin increases for IDTA members, the more relevant metric in terms of capital planning in actual practice, was 37.23%, or $27.52 million[11].

FICC did not state the average percent net capital increase across all members. The IDTA gathered data from its members and the average margin increase as a percent of their net capital is 5.1%, but 16.0% for the top 100 days in terms of margin increases[12].

	MMA Average VaR Increase %	MMA Average Net Capital Increase %
Total increase over 2 years	14.6%	5.1%
Top 1 day	50.7%	25.9%
Top 10 days	48.3%	23.5%
Top 50 days	42.7%	19.1%
Top 100 days	37.2%	16.0%

4. Delays in Communication/Data Provision – During the preparation of this comment letter, the IDTA sought to gather IDTA member data with regard to VaR increases in order to conduct a more accurate analysis. However, many FICC members did not receive their margin impact reports from FICC until three weeks after the SEC request was filed. Furthermore, some of this delay was caused by errors in data, which FICC corrected before providing IDTA members with data. If similar errors persist, they may create issues with the implementation of the MMA in the future. And at the very least, these delays also delayed the process of putting together this comment letter.

5. Cumulative Charges – Furthermore, FICC's ability to and history of imposing special charges increases the actual VaR increase which IDTA members must bear on the most volatile days. Accounting for the proposal's stated average SOD VaR charge increase of 17.69% and a potential special charge of 10%, the actual VaR charge increase on a given volatile market event day might actually be 27.69%. However, as noted above, the actual average VaR increase on the most volatile days, the exact type of days on which the special charge might be levied, is 37.23% for the IDTA, amounting to a total of **47.23%** as the actual VaR increase which IDTA members would be required to anticipate in terms of capital planning.

   While FICC's special charge is of a limited duration and temporary, the IDTA is very concerned that FICC may continue to impose special charges even if the MMA proposal is increased and, absent a contrary statement, this higher charge represents a much higher burden on middle market dealers than the proposal initially represented.

   This concern has been raised with FICC/DTCC and there does appear to be some degree of uncertainty how such the recently announced new "special charge" will be implemented if the current MMA proposal is approved. It certainly is encouraging that there is a recognition that, implemented incorrectly, the combination of the proposed MMA and the special charge would, particularly for the middle market firm, be a piling on of punitive levels of new margin. This makes it imperative that the SEC carefully and comprehensively consider these effects as they

[11] See attached analysis of IDTA member data.
[12] See attached analysis of IDTA member data.

consider this proposal and other policies implementing the Treasury clearing mandate. The members of the IDTA will continue working with FICC on these issues, but this issue should be addressed by the SEC as you consider these issues.

Any increase in margin which does not take into account the impact on the different types, sizes, and specialties of market participants does not benefit the Treasury market as a whole, nor does it benefit U.S. taxpayers. And since SIFIs are the ones most able to shrug off the consequences of an imprecise MMA VaR increase, the risks of market concentration are heightened. Regulators must employ heightened scrutiny concerning any increases in pricing and margin to avoid the unintended consequences of allowing bank concentration risk to continue to increase.

Impact on Treasury Market Liquidity

Markets with high margin costs have fewer market participants. Less competition decreases liquidity and creates wider bid/offer spreads. When costs increase, market participants either exit the market or pass the additional expenses to their customers.

In order to squeeze the .13% confidence level from the VaR model, FICC eliminated netting across the belly of the curve. In the FICC VaR model, securities are broken down into different maturity buckets: 1-year to 3-year, 3-year to 5-year, 5-year to 10-year. In the traditional VaR model, there are offsets between buckets. A long position in one bucket partially offsets a short position in another bucket. A long position in the 2 Year Note is mostly offset by a short position in the 3 Year Note. Yes, there is some yield curve risk, but, in general, the risks are offset.

Under the new MMA model, the offsets are eliminated. This means there would be gross margining across maturity buckets. A 2.9-year security's risk is no longer offset by a 3.1-year security. The full margin is collected on both sides of the transaction.

This will decrease liquidity at Treasury auctions. All three maturity buckets are anchored by a US Treasury on-the-run issue. Many buyers at Treasury auctions "roll backwards" ahead of the auction. They will short-sell the WI issue and buy the outstanding 3-year, 5-year, or 10-year Treasury. This allows them a hedge when bidding at the auction. Under FICCs MMA proposal, the WI[13] 3-year, WI 5-year, and WI 10-year securities will be in separate maturity buckets from the outstanding issues. There will no margin offsets and investors will be margined gross instead of net. This clearly reduces participation and liquidity at Treasury auctions.

The impact will not only occur at Treasury auctions. The entire belly of the Treasury curve will change from net margining (where the risk is measured correctly) to gross margining (where the risk is over-estimated). Distortions will occur in Butterfly Spread and "roll down the curve" trading strategies. In a Butterfly Spread, a trader owns one security and short-sells a security with a longer maturity and short-sells a security with a shorter maturity. These trades are often spread over FICC margin buckets.

To some, this may not seem significant, however, increased margin requirements always mean less trading activity, less arbitrage keeping prices in line, which naturally lead to less liquidity and wider bid/offer spreads. Wider bid/offer spreads mean a higher cost to US taxpayers. In other words, the increased margin requirements as proposed may achieve the 99% confidence, but with

[13] When Issued

the significant cost of increased cost to market participants, including the issuer of Treasury securities, and increased market concentration risk.

Conclusion

IDTA shares a desire to see a stable and safe CCP, but the MMA proposal is materially flawed in the following ways:

- The new MMA margin will result in an increase in margin, the effects of which are not fully understood due to the misleading and inaccurate study.
- The MMA VaR increase is disproportionately burdensome compared to the 0.13% of VaR model confidence which FICC seeks to increase.
- The proposal increases margin for smaller FICC members, which will ultimately ensure a larger market share for SIFIs and the largest banks and broker dealers.
- The actual margin increase is much higher than that represented in the proposal and will unfairly burden smaller FICC members.
- The large SIFI banks represent systemic risk far beyond the smaller FICC participants and are better able to mitigate their own risks. The MMA should be applied to the largest FICC members only, or should at least reflect an accurate proportion of the risk posed by different segments of the market.
- Regulators and CCPs cannot continue to increase margin requirements and costs in the Treasury market without first minimizing the impact on liquidity.
- An accurate market impact study which reflects the full breadth of the market, not the largest and smallest players, needs to be implemented. The IDTA would appreciate the opportunity to participate.

We urge the Commission to carefully consider the potential impacts of the FICC MMA proposal to the market, especially on market concentration and liquidity based on accurate and realistic data. We also urge the adoption of alternative methods to increase the confidence level of FICC's VaR model back-testing that would not unfairly prejudice middle market and independent dealers. The IDTA thanks the Commission for considering our comments. Should you have any questions, please contact our outside regulatory counsel, Micah Green at Steptoe LLP at mgreen@steptoe.com.

Sincerely,

Independent Dealer and Trader Association

Board of Directors:
James Tabacchi, South Street Securities LLC
Scott Skyrm, Curvature Securities LLC
Lara Hernandez, Mirae Asset Securities (USA), Inc.
Stephen Hood, Marex Group
Richard Misiano, Buckler Securities
Michael Santoro, Loop Capital Holdings
Philip Vandermeuse, TransMarket Group
Richard Mackey, Prime Trading LLC

cc: Honorable Gary Gensler, Chairman
Honorable Hester M. Peirce, Commissioner
Honorable Caroline A. Crenshaw, Commissioner
Honorable Mark T. Uyeda, Commissioner
Honorable Jaime Lizarraga, Commissioner

Haoxiang Zhu, Director, Division of Trading and Markets
Jessica Wachter, Director, Division of Economic and Risk Analysis