

June 20, 2024

Ms. Vanessa Countryman
Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: *Notice of Filing of Proposed Rule Change, as Modified by Partial Amendment No. 1, To Modify the GSD Rules to Facilitate Access to Clearance and Settlement Services of All Eligible Secondary Market Transactions in US Treasury Securities (File No. SR-FICC-2024-005) and Notice of Filing of Proposed Rule Change to Modify the GSD Rules (i) Regarding the Separate Calculation, Collection and Holding of Margin for Proprietary Transactions and That for Indirect Participant Transactions, and (ii) To Address the Conditions to Note H to Rule 15c3-3a (File No. SR-FICC-2024-007)*

Dear Ms. Countryman:

The Investment Company Institute¹ is writing in response to the Securities and Exchange Commission's ("SEC" or "Commission") notice regarding the above-referenced proposed rule changes by Fixed Income Clearing Corporation ("FICC") ("Proposals").² Each of the two proposals, which we describe in more detail herein, has been issued to implement the SEC's

¹ The [Investment Company Institute](#) (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage \$34.1 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional \$9.4 trillion in regulated fund assets managed outside the United States. ICI also represents its members in their capacity as investment advisers to certain collective investment trusts (CITs) and retail separately managed accounts (SMAs). ICI has offices in Washington DC, Brussels, and London and carries out its international work through [ICI Global](#).

² *Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Change as Modified by Partial Amendment No. 1, to Modify the GSD Rules to Facilitate Access to Clearance and Settlement Services of All Eligible Secondary Market Transactions in U.S. Treasury Securities*, Exchange Act Release No. 34-99817 (Mar. 21, 2024), 89 Fed. Reg. 21362 (Mar. 27, 2024), available at <https://www.govinfo.gov/content/pkg/FR-2024-03-27/pdf/2024-06446.pdf> (the "Access Model Proposal"); *Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Modify the GSD Rules (i) Regarding the Separate Calculation, Collection and Holding of Margin for Proprietary Transactions and That for Indirect Participant Transactions, and (ii) to Address the Conditions of Note H to Rule 15c3-3a*, Exchange Act Release No. 34-99844 (Mar. 22, 2024), 89 Fed. Reg. 21603 (Mar. 27, 2024) (the "Margin Segregation Proposal"), available at <https://www.govinfo.gov/content/pkg/FR-2024-03-28/pdf/2024-06577.pdf>.

recently adopted rules under the Securities Exchange Act of 1934 (the “Exchange Act”) relating to the central clearing of transactions in US Treasury securities (“Treasury Clearing Rule”).³

ICI’s members, which include US-registered investment companies—mutual funds, ETFs, money market funds, and other funds that are regulated under the Investment Company Act of 1940, as amended (“1940 Act”) (“registered funds”)—and non-US regulated funds⁴ (together with registered funds, “regulated funds” or “funds”), along with their advisers, are among the most significant investors in the US Treasury markets, including the US Treasury repo market. The ability of funds to access these markets in an efficient and cost-effective manner is critical to their ability to achieve their investment objectives. Thus, ICI has a strong interest in ensuring that the implementation of the Treasury Clearing Rule by FICC will continue promote such access.

As we discuss in further detail below, our comments to the Proposals are as follows:

- The Commission should encourage FICC to propose further rule changes or take other measures that would encourage Netting Members to support done away clearing, including under FICC’s Sponsored Service.
- FICC should ensure that the FICC GSD Rules, including the proposed rule changes related to the customer or PAB reserve formula, account for the conditions of the no-action relief from 1940 Act custody requirements provided in the Treasury Clearing Rule. Otherwise, funds will not be able to post margin directly.
- The Commission should take further steps to encourage FICC to add features that would permit (but not require) Sponsored Members to support their obligations to FICC through direct posting of margin. In enabling direct posting, however, FICC should not impose conditions that create regulatory uncertainty under the 1940 Act or make such arrangements more operationally difficult.
- FICC should take additional steps to address ongoing concerns about the treatment of fund assets in bankruptcy where a fund is a Sponsored Member or participating in the Agent Clearing Service.

³ *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*, Securities Exchange Act Release No. 99149 (Dec. 13, 2023), 89 Fed. Reg. 2714 (Jan. 16, 2024) (the “Treasury Clearing Rule Adopting Release” and the rules adopted pursuant to that release are referred to herein as the “Treasury Clearing Rule”), *available at* <https://www.govinfo.gov/content/pkg/FR-2024-01-16/pdf/2023-27860.pdf>.

⁴ “Non-US regulated funds” refer to funds that are organized or formed outside the United States and are substantively regulated to make them eligible for sale to retail investors, such as funds domiciled in the European Union and qualified under the UCITS Directive (EU Directive 2009/65/EC, as amended), Canadian investment funds subject to National Instrument 81-102, and investment funds subject to the Hong Kong Code on Unit Trusts and Mutual Funds.

I. Access Model Proposal

A. Summary of the Access Model Proposal

The Access Model Proposal consists of several modifications to FICC’s Government Securities Division (“GSD”) Rulebook (“FICC GSD Rules”). The proposal is designed to address the requirement under Rule 22ad-22(e)(18)(iv)(C) that a covered clearing agency (“CCA”) have written policies and procedures reasonably designed to “ensure that it has appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in US Treasury securities, including those of indirect participants.”⁵ Under the Access Model Proposal, the Rules would be modified as follows:

Agent Clearing Service Proposal: Re-name and consolidate FICC’s current correspondent clearing/prime broker service offerings as the “Agent Clearing Service,”⁶ with a corresponding rule regarding its operation and requirements. Under this access model, FICC would allow a Netting Member (designated as an “Agent Clearing Member”) to process and record the activity of “Submitting Member” customers (designated as “Executing Firm Customers”) in separate “Agent Clearing Member Omnibus Accounts” to facilitate FICC monitoring and risk management of Agent Clearing Service activity. FICC believes that the Agent Clearing Proposal will allow market participants, including indirect participants, “to recognize the similarities between FICC’s indirect access model and [futures commission merchant (“FCM”)] agent clearing models and to identify the [service] as a workable ‘done away’ model.”⁷

Membership Qualification Proposal: Update the qualifications for certain membership categories and rules governing the operation of GSD’s access model for the Sponsored Service (as defined in the Membership Qualification Proposal). The Member Qualification Proposal would, among other things, remove the requirement that Sponsored Members (as defined under the FICC GSD Rules) using FICC’s Sponsored Service either be “qualified institutional buyers” (as defined in Rule 144A under the Securities Act of 1933) or otherwise satisfy the financial requirements of such definition.⁸ FICC stated that these changes would “enable access to FICC’s clearing and

⁵ SEC Rule 22ad-22(e)(18)(iv)(C).

⁶ Materials published by FICC explain that a “Done-Away Agent Clearing Transaction is a trade executed between an Agent Clearing Member’s Executing Firm Customer and another GSD Netting Member or an Agent Clearing Member’s Executing Firm Customer and an Executing Firm Customer of another Agent Clearing Member.” See FICC’s Client Clearing Capabilities for Treasury Market Activity at 4 (May 2024) (“FICC Client Clearing Summary”), available at <https://www.dtcc.com/USTclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Client-Clearing-Capabilities-for-Treasury-Market-Activity.pdf>.

⁷ FICC noted that “[m]arket participants also did not appear to understand the [current] agent clearing services as a workable ‘done away’ model that allows indirect participants to access clearing through multiple direct participants.” Access Model Proposal at 21363.

⁸ The Access Model Proposal also would simplify the FICC GSD Rules that describe the criteria and other requirements for the types of memberships available to legal entities that want to access the GSD’s central clearing services and the means of access for those services (including indirect access). This involves establishing a “public road map of the different models for accessing the GSD services,” and a simplification of the definitions relating to

settlement services for a variety of direct and indirect participants who may not currently be able to access those services.”

B. Comments on the Access Model Proposal

Although ICI supports efforts by FICC and the industry to establish a “workable” done away clearing model,⁹ it is not clear that the Agent Clearing Proposal fully implements the requirements of the Treasury Clearing Rule relating to fair and open access by indirect participants and ensuring appropriate means for such access by indirect participants such as funds. In relevant part, the rule requires that FICC, as a US Treasury CCA, “establish, implement, maintain and enforce written policies and procedures reasonably designed to” (1) “permit fair and open access by direct and, where relevant, indirect participants . . .”¹⁰ and (2) ensure that the CCA “has appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in US Treasury securities, including those of indirect participants. . . .”¹¹ At a high level, however, the Agent Clearing Proposal largely consists of a rebranding and consolidation of FICC’s existing correspondent clearing/prime broker services as the “Agent Clearing Service” without implementing substantive changes to those access models. Given the lack of substantive changes, it is uncertain whether a critical mass of funds would utilize the Agent Clearing Service to access FICC clearing on a “done away” basis, regardless of whether the industry creates the necessary documentation to facilitate done away clearing.¹² Importantly, there are also serious questions about whether Netting

the different types of membership, which “enhance the ability of market participants to understand the GSD access models that are available, thereby allowing them to determine how to offer and price FICC’s currently available models to ensure that indirect participants can access central clearing.”

⁹ We reiterate our earlier comments in our comment letter to the SEC on the Treasury Clearing proposal that FICC should focus on enhancing the “done away” clearing model further and that the SEC should “encourage FICC to develop a ‘give-up’ model under sponsored clearing.” *See* Letter from Sarah A. Bessin, Deputy General Counsel, ICI and Nhan Nguyen, Assistant General Counsel, ICI to Vanessa A. Countryman, Secretary, SEC, (Dec. 23, 2022) (“2022 Letter”), available at <https://www.sec.gov/comments/s7-23-22/s72322-20153417-320838.pdf>.

¹⁰ SEC Rule 17ad-22(c)(18)(i).

¹¹ SEC Rule 17ad-22(c)(18)(iv)(c). The Commission, however, has reiterated that this does not require FICC to prescribe specific methods for market participants to obtain indirect access to FICC. Treasury Clearing Rule Adopting Release at 2771.

¹² We note that there is a considerable effort underway to create industry documentation necessary to support the “done away” clearing model. Given that FICC is required to implement the new requirements of the Treasury Clearing Rule by March 31, 2025, we also question whether the timing of FICC’s Agent Clearing Proposal is premature, notwithstanding the SEC’s timing requirements for FICC rule changes under the Treasury Clearing Rule. Further, ICI Members have concerns that their rights as Executing Firm Customers under proposed Rule 8 of the FICC GSD Rules, which would govern the Agency Clearing Service, are too limited in that FICC “shall have no obligations to the Executing Firm Customer,” the Executing Firm Customer shall have no right to receive from FICC “any payment or delivery obligations,” and FICC “shall make any such payments for redeliveries solely to the relevant Agent Clearing Member.” *See* proposed FICC GSD Rule 8, Section 6(d) and (e). Further, the no-action relief from 1940 Act custody requirements provided in the Treasury Clearing Rule (discussed below) does not extend to the Agent Clearing Service. This would mean that 1940 Act funds would not be able to directly support

Members view offering such services on an unbundled basis as practicable from a regulatory net capital perspective and whether a sufficient number of Netting Members will provide clearing services on a standalone basis (as opposed to bundling execution and clearing).

Given these concerns, the Commission should strongly encourage FICC to propose further rule changes or take other measures that would encourage Netting Members to support done away clearing in furtherance of the clearing mandate. The Commission should also encourage FICC to demonstrate the ways in which it is encouraging or incentivizing its Netting Members to support done away clearing. Further, while the Agent Clearing Proposal does not relate to the FICC GSD Sponsored Service, ICI requests that the SEC encourage FICC to revise its rules to encourage and incentivize a viable done away model for all access models, including both the Agent Clearing Service and the Sponsored Service. Taking these steps would be consistent with the Commission's view, which we strongly agree with, that "a workable done-away model will be critical to [the Treasury repo] market, to accommodate the increased central clearing that will result from implementation of" the clearing mandate.¹³

As part of this request, we believe that further explanation from FICC, or additional FICC GSD Rule changes, may be necessary to facilitate other "done away" clearing arrangements that funds may adopt, particularly under FICC's Sponsored Service. Specifically, FICC has asserted that it also offers "done away" clearing under its Sponsored Service,¹⁴ but does not provide details on this structure in the Access Proposal. To the extent that funds look to engage in "done away" clearing with Sponsoring Members (as defined under the FICC GSD Rules), it may be necessary for FICC to clarify several issues, such as how privity to FICC would be possible under "done away" clearing that involves a Sponsored Member and two Sponsoring Member firms (with one as executing Sponsoring Member and one as the sponsor for clearing).

Finally, we support the aspects of the Membership Qualification Proposal relevant to funds (*i.e.*, eliminating the Sponsored Member eligibility requirements other than it being sponsored by at least one Sponsoring Member).

their obligations to FICC through direct margin posting of margin rather than by paying fees to the Sponsoring Member that reflect the cost of its Clearing Fund contributions, further reducing the probability that a critical mass of funds would utilize the Agent Clearing Service.

¹³ Treasury Clearing Rule Adopting Release at 2757. ICI previously stated in its comments to the SEC's proposal that the adoption of an efficient give-up structure by Netting Members would generate increased competition among market participants, which may result in more efficient pricing. Further, an efficient give-up structure is essential under a clearing mandate because the current Sponsored Service may not be able to meet increased capacity requirements due to the limited number of Sponsoring Members and the increased demand for sponsored clearing under the Treasury Clearing Rule. 2022 Letter at 13-14.

¹⁴ FICC Client Clearing Summary at 12.

II. Margin Segregation Proposal

A. Summary of the Margin Segregation Proposal

Separate and Independent Calculation, Collection and Holding Proposal: The Margin Segregation Proposal provides for FICC GSD Rule changes requiring the separate calculation, collection, and holding of (1) margin supporting a Netting Member's proprietary transactions and (2) margin supporting the transactions a Netting Member submits on behalf of indirect participants. The Separate and Independent Calculation, Collection and Holding Proposal is designed to comply with the requirement that US Treasury CCAs have written policies and procedures reasonably designed to, as applicable, calculate, collect, and hold margin for transactions in US Treasury securities submitted on behalf of an indirect participant separately from those submitted on behalf of the direct participant.¹⁵

Reserve Formula Conditions Proposal: The Margin Segregation Proposal would also provide for FICC GSD Rule changes designed to satisfy the conditions under SEC Rule 15c3-3a to permit broker-dealers to record margin required and on deposit at a US Treasury CCA as a debit item in the customer or PAB reserve formula under SEC Rule 15c3-3a (the "Reserve Formula Conditions").

The Reserve Formula Conditions Proposal would permit a Netting Member, including a non-broker-dealer Netting Member, to designate certain Indirect Participant Accounts¹⁶ as "Segregated Indirect Participants Accounts." FICC stated that "such a designation would have the effect of causing FICC to calculate, collect, and hold the required margin for transactions recorded in such Accounts [(as defined under the FICC GSD Rules)] in accordance with the [Reserve Formula Conditions]."

¹⁵ Rule 17ad-22(e)(6)(i). As background, FICC has stated that it uses margin as a "key tool . . . to manage its credit exposures to members," and noted that the aggregate amount of all GSD members' margin constitutes the GSD Clearing Fund, which has the objective of mitigating "potential losses to FICC associated with liquidating a member's portfolio in the event FICC ceases to act for that member" (*i.e.*, in a member default). All Netting Members are required to make deposits to the Clearing Fund in an amount calculated under FICC GSD Rules (referred to as the "Required Fund Deposit"). FICC may determine the Required Fund Deposit calculation by reference to the Netting Member's proprietary transactions and the transactions it submits on behalf of indirect participants. Currently, Sponsored Member Trades are recorded in a separate Account from proprietary transactions and transactions the Netting Member carries for indirect participants through the correspondent clearing/prime broker services (which may be recorded in one Account referred to as the "Netting Member Account"). All Sponsored Member Trades are currently recorded in the same Sponsoring Member Omnibus Account but the Sponsoring Member's Clearing Fund Deposit component relating to Sponsored Member Trades is calculated separately for each Sponsored Member without netting across Sponsored Members.

¹⁶ An "Indirect Participant Account" would include (1) Sponsoring Member Omnibus Accounts for Sponsored Member Trades; and (2) for an Agent Clearing Member, Agent Clearing Member Omnibus Accounts for purposes of recording Agent Clearing Transactions of its Executing Firm Customers.

For such an Account:

- New FICC GSD Rule 2B would provide that FICC would calculate the Netting Member's "Segregated Customer Margin Requirement" on a gross basis as the sum of the margin requirements applicable to each Segregated Indirect Participant. FICC would not net the transactions of one Segregated Indirect Participant against the transactions of another Segregated Indirect Participant.¹⁷
- FICC GSD Rule 4, Section 1a would be amended to provide that FICC would segregate the margin deposited to support the transactions in the Segregated Indirect Participants Account from any margin securing a Netting Member's proprietary positions, both on FICC's own books and records and at FICC's custodians. Under the amended FICC GSD Rule 4, FICC would establish a "Segregated Customer Margin Custody Account" corresponding to each Segregated Indirect Participants Account of a Netting Member.¹⁸
- FICC GSD Rule 4, Section 1a would be amended to provide that "Segregated Customer Margin" credited to a Segregated Customer Margin Custody Account would be used exclusively to settle and margin transactions in US Treasury securities recorded in the corresponding Segregated Indirect Participants Account.¹⁹
- FICC GSD Rule 4, Section 4 and related provisions of the Rules would be amended to provide that Segregated Customer Margin would be subject to a separate security interest that would secure only obligations arising out of Segregated Indirect Participants Accounts. FICC GSD Rule 4, Section 5 would be amended to provide that FICC could only use the Segregated Customer Margin to secure or settle the performance of the obligations of the Segregated Indirect Participant (and its Sponsoring Member or Agent Clearing Member, as applicable with respect to the Segregated Indirect Participant's obligations), and would not be able to apply such margin to the proprietary obligations of

¹⁷ The Segregated Customer Margin Requirement would be calculated twice daily. The methodology for calculating margin for the Segregated Indirect Participant would be calculated similar to the Required Fund Deposit calculation, except there would be no "Excess Capital Premium" added (which is an amount designed to address the risk presented by a Netting Member with low capital value relative to its value-at-risk ("VaR") charge).

¹⁸ This Account would be a "securities account" under the New York Uniform Commercial Code ("NYUCC") that would be a traditional custodial account to which FICC would credit cash and securities. The Rule would provide that such assets are "financial assets" within the meaning of the NYUCC which would have the effect of making FICC the "securities intermediary" and the Netting Member, on behalf of its Segregated Indirect Participants, the "entitlement holder" under the NYUCC. The Segregated Customer Margin would not be treated as general Clearing Fund amounts, and the Account would be separate from any other Accounts maintained by FICC for the Netting Member, including fellow Segregated Customer Margin Custody Accounts. This addresses the condition set forth in the introductory text of Section (b)(2)(iii) of Note H.

¹⁹ This addresses the condition of Section (b)(2)(iii)(A) and Section (b)(2)(iii)(C) of Note H.

the Netting Member that deposited it with FICC or to the obligations of any other Netting Member or participant.²⁰

- New subsection 3(c) of FICC GSD Rule 4, Section 3 would be adopted to require that the Segregated Margin Requirement be no lower than \$1 million cash per Segregated Indirect Participant.
- FICC GSD Rule 4, Section 1a would be amended to provide that all Segregated Customer Margin be held in an Account of FICC at a bank within the meaning of the 1940 Act that is insured by the Federal Deposit Insurance Corporation or at the Federal Reserve Bank of New York, and that such account would be segregated from any other account of FICC and would be used exclusively to hold Segregated Customer Margin.²¹
- FICC GSD Rule 4 would be amended to require FICC to only invest Segregated Customer Margin consisting of cash in US Treasury securities with a maturity of one year or less.²²
- FICC GSD Rule 4, Section 10 would be revised to require FICC to calculate twice each Business Day the excess of the Segregated Customer Margin over the Segregated Customer Margin Requirement and require FICC to return a Netting Member's "Excess Segregated Customer Margin" at the Netting Member's request.²³ FICC, however, would retain discretion to retain such Excess Segregated Customer Margin if the relevant Netting Member has any outstanding payment or margin obligation with respect to the transactions of "any" Segregated Indirect Participant (which appears to include any fellow customer Segregated Indirect Participant).

FICC states that the "aim of these changes is both to allow broker-dealer Netting Members to collect margin from customers and deposit it with FICC and to provide all customers, including

²⁰ These rule amendments address the condition of Section (b)(2)(iii)(D) of Note H. FICC explained that this requirement would have the effect of limiting "fellow customer risk" for Segregated Indirect Participants but also noted that "a Segregated Indirect Participant's ability to recover any funds or securities it has posted to its Netting Member in connection with an FICC-cleared transaction or that the Netting Member receives from FICC in connection with such a transaction will depend on the relevant insolvency, resolution, or liquidation regime."

²¹ Each Account would be subject to certain notices and a contract that the Segregated Customer Margin in the Account is subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or Federal Reserve Bank or any person claiming through that entity. This addresses the eligible custodian conditions of Section (b)(2)(iv)(A)-(C) of Note H.

²² This addresses the conditions of Section (b)(2)(ii) of Note H.

²³ This addresses the condition of Section (b)(2)(v) of Note H.

those that access FICC through non-broker-dealers, to be able to segregate margin they deposit.”²⁴

B. Comments on the Margin Segregation Proposal

As we have previously noted, funds as Sponsored Member repo buyers do not post margin directly to FICC under the current sponsored clearing model. Instead, a fund’s Sponsoring Member will make a deposit to FICC’s Clearing Fund based on the cleared repo transaction activity of all of its Sponsored Members. In turn, a Sponsored Member may be required by its Sponsoring Member to pay fees to the Sponsoring Member reflecting the funding cost of such Clearing Fund contributions associated with its transactions (which fees may be embedded in the pricing of the transactions).

ICI supports several aspects of the Margin Segregation Proposal that would promote the ability of funds to directly post margin, which could further facilitate their use of cleared repo and reverse repo transactions and term repos.²⁵ Consistent with that support, we reiterate that the SEC should take further steps to encourage FICC to add features that would permit (but not require) Sponsored Members to support their obligations to FICC through direct posting of margin rather than by paying fees to the Sponsoring Member that reflect the cost of its Clearing Fund contributions.²⁶ In enabling the direct posting of margin by funds, however, FICC should not impose conditions that create regulatory uncertainty under the 1940 Act, or make such arrangements more difficult operationally. Accordingly, we discuss below recommended enhancements to aspects of the Reserve Formula Conditions Proposal.

1. Potential 1940 Act Custody Issues Must Be Addressed

We urge FICC to ensure that the FICC GSD Rules, including the proposed rule changes under the Reserve Formula Conditions Proposal, account for the conditions of the no-action relief from

²⁴ The Margin Segregation Proposal also would implement other FICC GSD Rule changes that would align the description of FICC’s margin methodology with the revised Account types, consolidate the terms relating to margin calculation in a single, easily identifiable schedule, and make certain changes to the methodology. In addition, the Margin Segregation Proposal would modify certain requirements relating to “Inter-Dealer Broker Netting Members” (which appear not to be applicable to funds).

²⁵ Consistent with our prior comments, for example, we support the required segregation of proprietary and indirect participant margin under the Separate and Independent Calculation, Collection and Holding Proposal. 2022 Letter at 19.

²⁶ As we noted in the 2022 Letter, under the Sponsored Service, a fund delivers cash in exchange for securities purchased by the fund under a repo and delivers securities in exchange for cash under a reverse repo arrangement. The Sponsoring Member then is required to provide credit support to the FICC Clearing Fund to guarantee performance of the Sponsored Member. Permitting funds to post margin directly could reduce costs for participating funds under both sponsored repo and reverse repo transactions. Although we support enabling funds to directly post margin, we reiterate our view that funds should have the option, and not a requirement, to do so. 2022 Letter at 14. Therefore, FICC should clarify that it does not intend to require that an indirect participant post margin.

1940 Act custody requirements provided in the Treasury Clearing Rule. Otherwise, funds will not be able to post margin directly.

Section 17(f) of the 1940 Act requires registered funds to maintain their securities and similar investments in the custody of a bank, a member of a national securities exchange, or to self-custody such assets subject to rules adopted by the Commission. Because FICC is not deemed to be a securities depository eligible to custody fund assets,²⁷ expanding its Sponsored Service for Treasury repo and reverse repo to allow funds to directly post margin to FICC requires addressing Section 17(f) of the 1940 Act. Acknowledging that direct posting of margin may lower overall costs,²⁸ the SEC provided time-limited no-action relief in the Treasury Clearing Rule, subject to certain conditions, that would facilitate such direct posting.²⁹

While the conditions to the Broker-Dealer No-Action Relief can be largely addressed through bilateral agreements between a fund and its Sponsoring Member, complying with the conditions to the FICC No-Action Relief requires FICC to adopt Rules that appropriately reflect those conditions. FICC, however, is silent in the Margin Segregation Proposal as to whether the Reserve Formula Conditions Proposal was intended to address the conditions of that relief. We are concerned, based on our initial review, that the Reserve Formula Conditions Proposal and other aspects of the Margin Segregation Proposal fail to fully address the conditions of the FICC No-Action Relief. Therefore, FICC's proposal may not enable a fund to avail itself of the Commission's relief and directly post margin to FICC.³⁰ We note the following examples where this may be the case:

²⁷ Historically, funds have not posted assets directly to FICC. Although FICC is registered as a clearing agency, FICC has stated that it is not a securities depository and does not provide securities depository services. FICC, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructure (Dec. 2021) ("FICC Disclosure Framework") at 83. Further, the SEC declined to opine on whether FICC's Government Securities Division could currently be considered a "securities depository" for purposes of Rule 17f-4 under the 1940 Act. Treasury Clearing Adopting Release at 2730.

²⁸ Treasury Clearing Adopting Release at 2728.

²⁹ Under the relief, the Commission takes the position that for a period of five years from the effective date of the Treasury Clearing Rule Adopting Release, registered funds utilizing an arrangement that permitted registered funds' margin to be posted with FICC (the "FICC No-Action Relief") or with a member of a national securities exchange (*i.e.*, a registered broker-dealer) (the "Broker-Dealer No-Action Relief") would not provide a basis for enforcement action under Section 17(f), subject to certain conditions. This relief allows FICC or a registered broker dealer (which as a Sponsoring Member could receive a fund's margin and post it to FICC on the fund's behalf) to be deemed to have custody of certain fund assets without qualifying as a custodian under Section 17(f) custodian. Treasury Clearing Rule Adopting Release at 2728.

³⁰ We further note that the relevant aspects of the Reserve Formula Conditions Proposal merely permit a Netting Member to designate fund accounts as Segregated Indirect Participants Accounts. There is no provision in the proposal that would allow a fund to require its Netting Member to do so and ensure that the fund will benefit from the ability to rely on the FICC No-Action Relief and the Broker-Dealer No-Action Relief. As a result, funds will need to negotiate this matter with their Sponsoring Members, further limiting the possibility that funds may engage in direct posting of margin.

- The fourth condition to the FICC No-Action Relief requires that “the entity that FICC uses to custody such margin is an eligible fund custodian under the 1940 Act and the applicable rules thereunder.” Proposed Section 1a of FICC GSD Rule 4 provides that all Segregated Customer Margin will be in an account of FICC “at a bank within the meaning of the Exchange Act that is insured by the Federal Deposit Insurance Corporation, or at the Federal Reserve Bank of New York.” We are not aware of which entity that FICC intends to use for segregation of margin, and it is not clear based on the text of the proposed rule cited above whether such entity will qualify as an eligible fund custodian under the 1940 Act.
- The fifth condition to the FICC No-Action Relief requires that “the margin provided by a registered fund is not subject to loss mutualization or allocation.” There is no explicit loss mutualization or allocation under the relevant aspects of the Reserve Formula Conditions Proposal. However, FICC GSD Rule 4, Section 10 allows FICC to retain Excess Segregated Customer Margin if the relevant Netting Member has any outstanding payment or margin obligation with respect to the transactions of “any” Segregated Indirect Participant, which appears to include any fellow customer Segregated Indirect Participant. It is possible that this provision could be viewed as subjecting the fund to an element of loss mutualization or allocation.
- The sixth condition to the FICC No-Action Relief requires that “the margin provided by a registered fund is not used by FICC for any purpose other than in connection with that registered fund’s default as a Sponsored Member.” However, FICC GSD Rule 4 provides that FICC can invest the margin and use it to settle transactions without limitation to default. This provision could be construed as a use beyond that in connection with the fund’s default.
- The eighth condition to the FICC No-Action Relief requires that “the account into which a registered fund’s margin is deposited is governed by a contract by and among the registered fund, its Sponsoring Member, and FICC providing for an arrangement consistent with” the FICC No-Action Relief. It is possible that the Commission would not view this element as being addressed by the Sponsored Membership Agreement among the fund as Sponsored Member, the Sponsoring Member and FICC, and the related application of the FICC GSD Rulebook to the relationship among these parties, in which case bespoke agreements would need to be negotiated and entered into prior to a fund being able to rely on the FICC No-Action Relief.

Accordingly, the SEC should encourage FICC specifically to address the conditions to the FICC No-Action Relief in the FICC GSD Rules in a future proposal or otherwise to explain, in a public statement, how the conditions are satisfied.

2. Eliminate Disincentives to Direct Posting of Margin

FICC has not justified its proposed \$1 million minimum segregated margin requirement for each Segregated Indirect Participant, which could disincentivize funds from posting margin directly to FICC. FICC explained that this proposed minimum level is consistent with the minimum cash

requirement applicable to each Margin Portfolio of a Netting Member. FICC further characterized the proposed amount as an optimal “balance between financial impact of the requirement to Members and FICC’s ability to continue to meet its regulatory obligation to maintain a backtesting performance coverage ratio above its 99 percent coverage target.”³¹ Additionally, FICC asserted that it is appropriate to apply the same minimum cash requirement to each Segregated Indirect Participant because FICC would calculate margin requirements on a gross basis as if such participant had a separate Margin Portfolio. FICC also pointed out that the minimum requirement is calibrated to “mitigate the risk exposures presented” by the fact that FICC would be restricted from using such funds to address losses other than those resulting from the relevant Segregated Indirect Participant.

Using the minimum amount applicable to Netting Members for their proprietary positions is not an appropriate basis for establishing a minimum threshold applicable to funds as indirect participants. Further, the reference to the financial impact of the requirement to Members is without any support or analysis as to the level of margin attributable to a typical fund’s positions in cleared Treasury repo, which is data FICC should have readily available. This arbitrarily high minimum amount may place an undue financial burden and otherwise disincentive funds from posting margin directly. As noted above, the Commission has acknowledged that allowing funds to post margin directly could lower trading costs, and this proposed minimum could undermine achieving that result. Accordingly, we recommend that FICC modify the proposed \$1 million minimum segregated margin requirement and instead apply the unadjusted risk-based calculation to Segregated Indirect Participants such as funds without any minimum charge.

In addition, the Proposal does not fully assure that any interest earned on Segregated Customer Margin will be credited to a Segregated Indirect Participant. Proposed FICC GSD Rule 4, Sections 3a and 3b would provide that (1) interest on Segregated Customer Margin consisting of cash be paid to Netting Members and (2) interest on Segregated Customer Margin be credited to the associated Segregated Customer Margin Custody Account. There is no corresponding requirement that Segregated Customer Margin consisting of cash be deposited in an interest-bearing account or otherwise invested, or that any such interest paid to Netting Members be paid through to the relevant Segregated Indirect Participants. This contrasts with the approach of other clearinghouses in other asset classes used by funds.³²

Therefore, the Commission should encourage FICC to ensure that such interest is earned and paid or credited to each relevant Segregated Indirect Participant and to explain publicly the basis for any interest rate to be so paid. Further, a fund that is a government money market fund is required under Rule 2a-7 to invest 99.5 percent or more of its total assets in “cash, government securities, and/or repurchase agreements that are collateralized fully.” The Commission should

³¹ Margin Segregation Proposal at 21611. FICC noted that it has identified through daily backtesting of Clearing Fund deposits a “heightened likelihood of backtesting deficiencies for members with lower deposits that are not sufficient to mitigate any abrupt intraday change in their exposures.” *Id.*

³² See, e.g., CME Clearing, Cash Interest Pass-Through Program – FAQ (Jan. 28, 2020), available at <https://www.cmegroup.com/clearing/financial-and-collateral-management/files/interest-pass-through-rate-faq.pdf>.

encourage FICC to provide a means for government money market funds to ensure that any amounts posted with FICC as margin are invested in accordance with such standard.

3. Operational Concerns Relating to Direct Posting of Margin

The Proposal does not specify from an operational perspective how FICC will facilitate the direct posting of margin by funds or posting of margin by a fund to a Netting Member, who would then post it to FICC. The Commission should urge FICC to make clear to funds how, from an operational perspective, indirect participants will be able to post margin.

III. Bankruptcy Treatment Issues Arising Under the Proposals Must Be Addressed

As we have previously noted, the operation of FICC's Sponsored Service and the Agent Clearing Service under the Proposals raise potential questions regarding the treatment in bankruptcy of fund assets, where a fund is a Sponsored Member or participating in the Agent Clearing Service.³³ We reiterate our concerns raised in the 2022 Letter about how FICC GSD Rules may not adequately address a Sponsoring Member or agent default, including a bankruptcy scenario.

We recognize that the SEC addressed certain of these concerns in the Treasury Clearing Rule, explaining that the Rules address certain aspects of closeouts upon FICC or Sponsoring Member insolvency.³⁴ However, the SEC's summary response provided in the Treasury Clearing Rule Adopting Release does not provide industry participants with enough certainty on these issues. We therefore urge FICC to provide a legal opinion to each of its direct and indirect members addressing each of the points raised in our prior comment letter³⁵ and those additional points

³³ ICI previously raised several concerns in the 2022 Letter regarding how closeouts in the Sponsored Service will operate. 2022 Letter at 20-21. For example, because Agent Clearing Service transactions may include "done away" transactions as well as "done with" transactions, FICC GSD Rules need to address how closeout will work in a variety of different factual situations. The procedures will vary depending upon: (i) whether a Sponsoring Member, a Sponsored Member, or a done away counterparty (or each of them or a combination of them) is insolvent or is otherwise a defaulting party; (ii) whether the default occurred in connection with the start leg or the end leg; and (iii) where the transaction is settling from a custody perspective. In all cases, FICC should have closeout rights upon a delivery or payment default. As another example in the 2022 Letter, if FICC begins to support (but not require) Sponsored Members such as funds in the posting of margin, then the SEC and FICC should clarify that margin posted by a Sponsored Member with its Sponsoring Member for on-posting with FICC would be eligible for customer treatment under SIPA (in an opinion or otherwise).

³⁴ Treasury Clearing Rule Adopting Release at 2731.

³⁵ The 2022 Letter stated that (1) FICC GSD Rules should confirm that agreements entered into by repo counterparties will be enforceable by both parties, notwithstanding that the transactions are clear, and provide for a clear process for closeout of transactions by FICC, including both the start and end legs of the transaction, (2) the FICC GSD Rules need to address what happens upon the insolvency of a sponsoring member in a variety of different factual situations, because Sponsored Service transactions may include "done away" transactions, (3) the FICC GSD Rules should provide clarity regarding how non-defaulting parties can exercise closeout rights, (4) if permitting (but not requiring) Sponsored Members to post margin directly, the SEC and FICC should clarify that the margin posted with Sponsoring Members would be eligible for customer treatment under the Securities Investor Protection Act ("SIPA"), and (5) clarification of FICC GSD rules regarding exercise of closeout rights is important

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raised herein. FICC has publicly acknowledged that it obtains netting opinions and makes them available to its members upon request. We believe it is a reasonable expectation for FICC to provide closeout opinions as part of the onboarding process without being requested.³⁶ It is critical that the SEC and FICC provide certainty on these issues.

In addition, the Rules also should address the situation of a Corporation Default simultaneous with FICC ceasing to act with respect to a Sponsoring Member and provide affirmative rights to the Sponsored Member to promptly close out and manage its positions. Otherwise, a fund could be left with no recourse in such situation.

* * * *

We hope that this information and recommendations are helpful to the Commission as it considers how to proceed on the Proposal. If you have any questions, please contact Sarah Bessin at sarah.bessin@ici.org, Nhan Nguyen at nhan.nguyen@ici.org, Kimberly Thomasson at kthomasson@ici.org, or Philip Hinkle, of Dechert LLP, at philip.hinkle@dechert.com.

Regards,

/s/ Sarah A. Bessin

/s/ Nhan Nguyen

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The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw
The Honorable Mark Uyeda
The Honorable Jaime Lizárraga

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to clarify a repo counterparty's rights under different insolvency regimes applicable to cleared repo transaction, particularly with respect to "done away" trades. 2022 Letter at 20-21.

³⁶ See FICC – GSD FAQ, available at <https://www.dtcc.com/ustclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-GSD-FAQ.pdf>.

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