

FIA PTG

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April 17, 2024

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: FICC Rule Proposals to Facilitate Access to Clearance and Settlement Services and to Segregate Client Margin (SR-FICC-2024-005, SR-FICC-2024-006, and SR-FICC-2024-007)

Dear Ms. Countryman:

The FIA Principal Traders Group (“FIA PTG”)¹ appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the “Commission”) in response to the Fixed Income Clearing Corporation’s proposals to revise its customer clearing access models² and to modify its margin segregation rules³ (collectively, the “FICC Proposals”).

FIA PTG has consistently supported efforts by the official sector to increase transparency, liquidity and resiliency in the Treasury market, including by transitioning more trading activity in U.S. Treasuries (both cash and repo) to central clearing. At the same time, we have identified practical steps necessary to facilitate such a transition, such as (a) fair and efficient access for indirect participants (via a customer clearing model that is agnostic to the identity of the executing counterparty) and (b) cross-margining for indirect participants.⁴ Importantly, the Commission

¹ FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy and has previously made recommendations about a variety of equity market structure issues, including Regulation NMS.

² 89 Fed. Reg. 21362 (Mar. 27, 2024) (“Access Model Proposal”).

³ 89 Fed. Reg. 21603 (Mar. 28, 2024) (“Margin Proposal”).

⁴ See generally “Clearing a Path to a More Resilient Treasury Market,” FIA PTG (July 2021), available at: https://www.fia.org/sites/default/files/2021-07/FIA-PTG_Paper_Resilient%20Treasury%20Market_FINAL.pdf.

acknowledged in its clearing rule the importance of resolving both of these issues prior to implementing a clearing mandate in the Treasury market.⁵

Unfortunately, the current filings do not address either of these key issues, raising serious questions as to whether they are consistent with the requirements of the SEC Clearing Rule and the Exchange Act regarding access and competition. Below, we detail key outstanding issues that must be addressed prior to implementing the clearing mandate and additional questions that arise from the new customer clearing models proposed by FICC.

I. Key Outstanding Issues

The FICC Proposals set forth four different customer clearing access models:

- The current “Sponsored Clearing” offering where clearing members typically post margin on behalf of their customers and margin for customer positions is calculated on a gross basis. (**Sponsored (Legacy)**)
- A slightly revised and renamed⁶ “Agent Clearing” offering where clearing members typically post margin on behalf of their customers and margin for customer positions is calculated on a net basis. (**Agent Clearing (Legacy)**)
- A new version of the “Sponsored Clearing” offering where customers post margin that will be segregated at FICC and, as above, margin for customer positions is calculated on a gross basis. (**Sponsored (Segregated)**)
- A new version of the “Agent Clearing” offering where customers post margin that will be segregated at FICC and margin for customer positions is calculated on a gross basis. (**Agent Clearing (Segregated)**)

Despite the number of different models, key issues remain unaddressed.

1. “Done-Away” Customer Clearing

In stark contrast to other cleared asset classes, clearing members at FICC can require customers to bundle execution and clearing by only clearing transactions executed with that clearing member (“done-with transactions”). This has led to a lack of “done-away” clearing (i.e., the clearing of

⁵ 89 Fed. Reg. 2714 (Jan. 16, 2024) (“SEC Clearing Rule”) at 2714 (“a covered clearing agency providing central counterparty services for U.S. Treasury securities [must] 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 2751 (“the Commission continues to believe that market participants can benefit from cross-margining arrangements and encourages U.S. Treasury securities CCAs to consider the potential of such benefits”).

⁶ The current “correspondent” and “prime broker” clearing models are renamed to “agent clearing.”

customer transactions executed with *other* execution counterparties)⁷ under the current FICC access models, which has several negative consequences for customers and the overall market, and impedes implementation of the Commission’s clearing mandate.

For example, to clear Treasury repo transactions subject to the clearing mandate, firms will have to establish a separate clearing relationship with each executing counterparty, fragmenting cleared portfolios, increasing cost, complexity, and operational risk, and potentially limiting the number of execution counterparties with whom firms interact. And for Treasury cash transactions executed by interdealer brokers (“IDB”), there would appear to be no way to comply with the clearing mandate via customer clearing, as the execution counterparty (i.e. the interdealer broker) does not offer customer clearing services, and therefore another clearing member must accept these trades via a “done-away” offering.

The FICC Proposals do not improve the current *status quo*, as clearing members will still be permitted to require all customers to bundle execution and clearing services under *each* of the four customer clearing models detailed above. While FICC may continue to point-out that these models permit “done-away” clearing to the extent a clearing member elects to offer it, this line of argument ignores the current reality (where we are not aware of any clearing member currently offering “done-away” clearing to FIA PTG members for either cash or repo transactions)⁸ and fails to explain why “done-with” and “done-away” transactions continue to be treated differently given that a clearing member should be agnostic about with whom a trade is executed, as the counterparty of a cleared trade is FICC (not the executing counterparty). Particularly with respect to the new “Sponsored (Segregated)” and “Agent Clearing (Segregated)” models, where the customer is posting the required margin, FICC has not explained the justification for treating “done-with” and “done-away” transactions differently and why it has elected to continue to permit its clearing members to require *all* customers to bundle execution and clearing in these models.

In light of the above, and in particular the fact that cash transactions covered by the clearing mandate cannot be cleared via customer clearing unless clearing members offer “done-away” clearing to the firms participating in the IDB segment of the market, the current approach raises serious questions regarding whether the FICC Proposals appropriately facilitate access to clearing for indirect participants as required by the SEC Clearing Rule.⁹ By electing not to ensure that “done-away” clearing will be available to all in-scope firms via *any* of the available customer

⁷ We note that a more limited (and inaccurate) definition of “done-away” is provided in FICC’s proposed amendments to its risk management framework that solely references transactions between two indirect participants (*see* 89 Fed. Reg. 21068, 21069).

⁸ We note that some “done-away” clearing for cash transactions may be occurring through the Agent Clearing (Legacy) offering, typically by clearing members other than the major clearing banks utilized by FIA PTG members in other asset classes, with a focus on smaller customers. As part of evaluating compliance with the SEC Clearing Rule, FICC should not only be considering whether to “enable” clearing members to elect to offer “done-away” clearing, but also whether to continue to permit clearing members to require *all* customers to bundle execution and clearing in certain models (*see* 89 Fed. Reg. 21068, 21069).

⁹ SEC Clearing Rule at 2830.

clearing models, the current approach creates significant uncertainty for market participants that will impede the implementation of the Commission's clearing mandate.

2. Adoption of the Available Customer Clearing Models

The FICC Proposals make four different customer clearing access models available. While intended to provide flexibility, this approach may ultimately introduce unnecessary complexity and confusion. In particular, this represents a much more complex approach than has been adopted in other cleared asset classes (including those cleared by other DTCC entities), and there will be significant uncertainty regarding whether clearing members (a) offer some or all of the models, (b) support different types of transactions in each model (for example, term repo and cash transactions are not widely supported in the current Sponsored (Legacy) model), or (c) offer significantly different pricing for each model. With FICC not required to implement the various customer clearing access models until March 31, 2025,¹⁰ these fundamental questions are likely to only be answered when the clearing mandate is mere months away, leading to significant uncertainty as to how market participants will comply.

In light of these concerns, we make two recommendations at the outset. *First*, FICC should re-assess whether all four models are strictly necessary; for example, as discussed below, we are not clear as to the necessity of having *both* the Agent Clearing (Segregated) and Sponsored (Segregated) models. *Second*, FICC should make public monthly statistics regarding clearing member adoption of the available customer clearing models. For example, this information should include, for each customer clearing model:

- the number of clearing members offering such model (separately reported for cash and repo transactions)
- the number of clearing members offering “done-away” clearing (separately reported for cash and repo transactions); and
- the total volumes cleared pursuant to such model, including number of transactions and total notional (separately reported for cash and repo transactions and whether such transactions were “done-with” or “done-away”).

The SEC Clearing Rule already contemplates that FICC will be collecting this information¹¹ and providing this transparency will help market participants navigate the available options in order to transition to central clearing.

¹⁰ SEC Clearing Rule at 2770.

¹¹ SEC Clearing Rule at 2757.

3. Customer Cross-Margining

Direct clearing members at FICC and CME can benefit from the cross-margining of correlated positions, which may significantly reduce overall clearing costs. However, customers cannot, which creates competitive disparities. While the Commission,¹² the CFTC Global Markets Advisory Committee,¹³ and FICC¹⁴ have all expressed support for permitting customers to utilize cross-margining, we remain concerned regarding the lack of tangible progress and the overall timeline. Taking into account the anticipated timeline for formal regulatory review, the window to obtain approval before the clearing mandate goes into effect is narrowing. To the extent this issue is not resolved, market participants will be faced with the choice of either (a) becoming a direct member of both FICC and CME in order to utilize the existing cross-margining framework (which may not be possible in the time remaining) or (b) competing on an unlevel playing field with direct members. Either of these outcomes may hinder the implementation of the Commission's clearing mandate. As such, we urge FICC to publish a roadmap for expanding its cross-margining framework, and to provide indirect participants with regular updates regarding status.

4. Permitting Clearinghouse Competition

While FICC is currently the only Commission-registered clearing agency for Treasury securities, the SEC Clearing Rule expressly acknowledges “the potential for multiple clearing agencies serving the U.S. Treasury market”¹⁵ and we have since seen other firms express an interest in entering the market.¹⁶ However, certain FICC rules inappropriately impede fair market competition by requiring direct members to clear certain transactions *at FICC*.¹⁷ In order for the

¹² SEC Clearing Rule at 2751 (“For these reasons, the Commission continues to believe that market participants can benefit from cross-margining arrangements and encourages U.S. Treasury securities CCAs to consider the potential of such benefits”).

¹³ <https://www.cftc.gov/PressRoom/Events/opaeventgmac110623>.

¹⁴ Letter from Murray Pozmanter, Managing Director and President of DTCC Clearing Agency Services dated December 7, 2022, available at <https://www.sec.gov/comments/s7-23-22/s72322-20153700-321268.pdf> (“DTCC and FICC believe that expanding cross-margining to indirect participant positions would further reduce clearing costs and align incentives with risk. FICC continues to engage with the Commission and the CFTC on a potential expansion”).

¹⁵ SEC Clearing Rule at 2722.

¹⁶ See, e.g., <https://www.reuters.com/markets/us/cme-group-bids-enter-us-treasuries-clearing-business-financial-times-reports-2024-03-12/>.

¹⁷ See, e.g., FICC Rule 2(7) (“if it is a Netting Member, to: (i) submit to the Corporation for comparison, pursuant to Rule 5, data on all of its eligible trades with other Netting Members”); Rule 5(1) (“A Member of the Comparison System must submit to the Corporation for comparison trade data on all of its trades that are of the type processed by the Corporation (including trades executed and settled on the same day), calling for delivery of Eligible Securities, between it or an Executing Firm on whose behalf it is acting, and another Member or an Executing Firm on whose behalf it or another Member is acting.”); Rule 11(3) (“Each Netting Member must submit to the Corporation for comparison and netting, pursuant to these Rules, data on all of its trades, (including trades executed and settled on the same day and trades executed between it or an Executing Firm on whose behalf it is acting) with other Netting Members (or an Executing Firm on whose behalf it or another Member is acting) that are eligible for netting pursuant to these Rules”); and Rule 18(2) (“Each Netting Member must also submit to the Corporation for netting and

FICC Proposals to satisfy Exchange Act requirements,¹⁸ FICC must revise its rules to permit its members to clear transactions at other covered clearing agencies if they elect to do so.

II. Detailed Analysis of the Proposed Customer Clearing Access Models

While the FICC Proposals contain important enhancements regarding customer margin segregation, other key issues remain, as detailed below.

1. Sponsored (Legacy) and Agent Clearing (Legacy) Models

	Sponsored (Legacy)	Agent Clearing (Legacy)	CFTC FCM Regime
Is Margin Posted for Customer Positions Subject to Loss Mutualization under the CCP's Default Management Process?	Yes	Yes	No
Can Clearing Member Require Bundling of Execution & Clearing?	Yes	Yes	No
Is FICC Pursuing Cross-Margining with CME for Customers?	No	No	N/A

The FICC Proposals suggest that certain of the customer clearing access models “operate similarly” to the CFTC regulatory framework for cleared derivatives.¹⁹ As illustrated above, that is not the case for either the Sponsored (Legacy) or Agent Clearing (Legacy) models, given that the margin posted for customer positions may be used by FICC for loss mutualization in the event of various default scenarios, such as a fellow customer default or a clearing member default. In addition, in contrast to the CFTC regulatory framework, clearing members are permitted to require all customers to bundle execution and clearing services in both of these models. We also understand that FICC is not pursuing customer cross-margining for either of these models, which may make them significantly less attractive to many customers covered by the Commission clearing mandate.

In light of the above, FICC should provide an explanation of the expected use cases for these two models. For example, it is our understanding that the Sponsored (Legacy) model was specifically designed for repo transactions, while the Agent Clearing (Legacy) model has primarily been used for relatively balanced portfolios of cash transactions where clearing members can benefit from net margining, and the major clearing banks typically utilized by FIA PTG members

settlement pursuant to these Rules data on each Repo Transaction (hereinafter, an “Eligible Repo Transaction”) executed by a Covered Affiliate that satisfies the following criteria”).

¹⁸ See, e.g., Exchange Act §17A(b)(3)(I).

¹⁹ See Access Model Proposal at 21366.

do not appear to be active in this offering.²⁰ Does FICC expect these trends to continue post-implementation of the mandate, given the availability of the new segregated models? In addition, FICC rules state that the Agent Clearing (legacy) model cannot be used for “brokered transactions” or GCF repo transactions; FICC should explain the reasons for these limitations, and the expected practical impact on the use cases above.

2. Sponsored (Segregated) and Agent Clearing (Segregated) Models

	Sponsored (Segregated) / Agent Clearing (Segregated)
Minimum Amount of Margin Posted for Customer Positions Per Client Clearing Relationship?	\$1M
Can Clearing Member Require Bundling of Execution & Clearing?	Yes
Is FICC Pursuing Cross-Margining with CME for Customers?	Yes

While these new models more closely resemble customer clearing in other fixed income asset classes, a number of topics require further consideration and clarification.

First, as noted above, clearing members are permitted to require all customers to bundle execution and clearing services in both of these models, even though the customer is posting the required margin. A lack of sufficient “done-away” clearing has the potential to interact with other elements of these models in problematic ways. For example, many customers may prefer these models due to the potential for cross-margining, but, at the same time, FICC is imposing a minimum margin amount of \$1 million in cash per customer in order to use these models (in contrast to the legacy models). To the extent customers are required to establish a separate clearing relationship with each executing counterparty due to a lack of “done-away” clearing, the \$1 million minimum will apply to each such clearing relationship, further increasing costs (particularly for smaller market participants) and potentially limiting the number of execution counterparties with whom firms interact.

Second, the FICC Proposals suggest that, even if a clearing member elects to offer “done-away” clearing, the customer will have to disclose the identity of its executing counterparty (i.e. the firm it traded with) to its clearing member.²¹ Requiring the disclosure of executing counterparties divulges confidential information regarding the customer’s trading activities and may lead to limitations being placed on executing counterparties, directly undermining a key benefit of central clearing. FICC must clarify whether this is in fact required under any of its customer clearing access models, and if so, the justification for such a requirement and how it is

²⁰ It would be helpful for FICC to explain why this is the case; for example, is there more punitive regulatory capital treatment under this model?

²¹ See Proposed FICC Rule 8(7c).

consistent with the SEC Clearing Rule and the Exchange Act, particularly given that such disclosure does not occur in other cleared asset classes, including those cleared by DTCC entities.

Third, the FICC Proposals should provide greater detail regarding the FICC default management process and whether there are any differences across these two models. For example, does FICC anticipate allowing customer positions to be ported to another clearing member in the event of a clearing member default and, if so, are further rule amendments required? The current lack of porting is a meaningful difference compared to clearinghouse rules in other asset classes. In addition, the FICC Proposals suggest that customer positions will always be closed-out under the Agent Clearing (Segregated) model, whereas FICC may elect to continue to settle customer positions under the Sponsored (Segregated) model in the event of a clearing member default.²² No explanation is provided for this apparent difference in treatment.

Fourth, there are a number of margin-related issues that would benefit from further clarification. For example, FICC should clarify that, to the extent a customer elects to enter into a margin financing arrangement with its clearing firm, the customer may still elect to segregate such posted margin. FICC should also clarify that the security interest granted by a customer pursuant to the new segregated models only applies to that specific customer's obligations to FICC, and not those of other customers.²³ In addition, FICC should explain why it is appropriate to calculate a customer's margin requirement "as if they were a netting member," even though the margin calculation for direct FICC members covers both initial margin and guaranty fund contributions (and customers are not expected to be contributing to the guaranty fund).²⁴ FICC should also explain why clearing members must specifically request the return of excess segregated margin, rather than this being returned in the ordinary course.²⁵

Finally, FICC should provide an explanation of the expected use cases for these two models. In particular, it is not clear why a clearing member or a customer would elect to use the Agent Clearing (Segregated) model instead of the Sponsored (Segregated) model, particularly given that the Agent Clearing (Segregated) model cannot be used for certain transaction types, as detailed above. For example, to the extent a clearing member offers "done-away" clearing, it can do so through the Sponsored (Segregated) model, which also provides customers with a direct contractual relationship with FICC.

As part of further explaining the expected use cases, FICC should explain whether the insolvency analysis regarding customer margin or close-out amounts owed to a customer in the event of a clearing member default would vary across these models and also compare such insolvency analysis to a customer's position when executing uncleared cash and repo transactions

²² Compare FICC Rules 3A(14c) and 22A(2b).

²³ See Proposed FICC Rule 4(4b), which states "As security for any and all obligations and liabilities of a Netting Member, any Sponsored Member, and any Executing Firm Customer to the Corporation arising out of or in connection with *any* Segregated Indirect Participants Accounts of such Netting Member or Transactions recorded therein." (emphasis added).

²⁴ See Proposed FICC Rule 4(1b(b)).

²⁵ See Proposed FICC Rule 4(10b).

with a broker-dealer in order to identify any benefits from a customer's perspective. This information is required in order for FICC to satisfy the requirement that it provide "sufficient information to enable participants to identify and evaluate risks incurred by participating in FICC."²⁶

III. Conclusion

We appreciate FICC's efforts to clarify its customer clearing access models and to provide for the segregation of customer margin. While the FICC Proposals represent an important first step, more is required to be done in order to comply with the SEC Clearing Rule. We look forward to continuing to engage with FICC and the Commission to expand access to clearing and to ensure that the marketplace is prepared to implement the clearing mandate.

If you have any questions, please do not hesitate to contact Joanna Mallers at jmallers@fia.org.

Respectfully,

FIA Principal Traders Group



Joanna Mallers
Secretary

cc: Gary Gensler, Chair
Hester M. Peirce, Commissioner
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²⁶ 17 C.F.R. § 240.17ad-22(e)(23)(ii).