ISDA | Safe, Efficient Markets

Submitted Electronically

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RE: 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[1]

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[2] appreciates the opportunity to provide comments to the Securities and Exchange Commission **("Commission**" or "**SEC**") on its proposal regarding *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* ("**proposal**").

ISDA's core mandate relates to the safety and efficiency of the derivatives markets but ISDA and its members have noted that inefficiencies in the U.S. Treasury ("**UST**") market could adversely affect collateral for derivatives and linked derivatives markets. ISDA also strongly supports efforts to ensure the resilience of cleared financial markets generally.

ISDA's Survey

Earlier this year, ISDA conducted a survey of market participants regarding ongoing efforts to incentivize and/or potentially require additional clearing of UST securities and repos. The survey sought feedback on the legal, operational, regulatory (including market regulation and capital implications) and policy issues associated with UST clearing, with a focus on client clearing and how reforms in this market would impact derivatives markets.[3]

The results of ISDA's survey showed a wide variety of views on whether increased clearing of UST securities and repos would materially improve the resilience and efficiency of the UST market, suggesting further research on the costs and benefits is necessary. While most respondents were generally supportive of clearing, very few supported broad clearing mandates,

[1] https://www.govinfo.gov/content/pkg/FR-2022-10-25/pdf/2022-20288.pdf
[2] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 990 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.
[3] A report summarizing the results is available at https://www.isda.org/2022/08/10/isda-us-treasury-clearing-survey-results/.

warning that any such requirements could result in some participants reducing their activity or withdrawing from the market, potentially reducing liquidity.

Many respondents to ISDA's survey did support reforms that they believed would increase efficiencies in the UST market and achieve many of the proposal's stated objectives. These reforms included relief under the supplemental leverage ratio ("**SLR**"), increased access to indirect clearing for clients who desire it, increased access to direct clearing for firms that meet applicable membership requirements, the ability to post client collateral to the clearing agency and approval of rules to enable additional cross-margining between cleared cash and futures markets (including at the client level). In some cases, respondents noted that these reforms may incentivize additional voluntary clearing in the UST market. Survey respondents also supported the G30's recommendation for the Fixed Income Clearing Corporation ("**FICC**" which, as noted in the proposal, is currently the only clearing agency offering clearing services for UST securities or repos) to have access to the Federal Reserve's Standing Repo Facility as an alternative to its existing Capped Contingency Liquidity Facility in order to mitigate against liquidity risk and risks to non-defaulting clearing members in the event of a clearing member default.[4] ISDA members have separately noted other potential incentives to clearing in the UST market, including separation of initial margin from assets subject to loss mutualization within FICC, which would mitigate higher risk-weighted assets ("**RWA**") under prudential capital regulations for certain clearing members relative to other clearing agencies with more traditional default fund structures. Such separation may also facilitate clearing for market participants that are subject to restrictions regarding exposure to loss mutualization.

On the other hand, many dealer respondents to ISDA's survey indicated that they did believe increased clearing, particularly in the UST repo market, would be beneficial to the overall market *provided that* the reforms mentioned above were effectively implemented. While it is unlikely that these reforms would be a panacea, they would all be incrementally beneficial to market functioning and, taken together, we expect that they would result in additional clearing in the UST market and therefore, many of the benefits mentioned in the proposal.

Amendments to Rule 15c3-3a

Consistent with the foregoing, ISDA strongly supports the proposed amendments to Rule 15c3-3a, which generally would permit margin required and on deposit at covered clearing agencies providing central clearing for UST securities to be included by broker-dealers as a debit in the customer and propriety reserve formulas. These amendments would effectively allow for posting of client collateral at FICC or any other covered clearing agency and would thereby remove an existing impediment to client clearing. Irrespective of whether the SEC finalizes and implements other aspects of the proposal, ISDA strongly encourages the SEC to implement the proposed amendments to Rule 15c3-3a to allow for greater and more efficient client clearing. However, in doing so, we encourage the SEC to remove the conditions for margin on deposit at

[4] https://group30.org/images/uploads/publications/G30_U.S_._Treasury_Markets-_Steps_Toward_Increased_Resilience__1.pdf.

covered clearing agencies providing central clearing for UST securities that do not apply to other clearing agencies. While it is critical to protect client margin and we strongly support safeguards necessary to provide such protection, the risks associated with UST clearing do not warrant different treatment.

Prudential Regulations

The SLR, RWA and GSIB surcharge are binding constraints on certain banks and have contributed to bank departures from various services and business lines. Permanent adjustments to risk-agnostic sized-based capital and balance sheet constraints such the SLR and GSIB surcharge would allow regulated banks to transact in the UST market in a more balance sheet efficient and cost effective manner and thereby achieve many of the proposal's stated objectives related to market liquidity and efficiency.[5] We recognize that the SEC does not itself have the ability to modify the SLR but we strongly encourage the SEC to work with prudential regulators to implement modifications prior to finalizing the proposal.

Clearing Models and Timing

The proposal requires covered clearing agencies that clear UST transactions to take steps that would facilitate access to client clearing. Consistent with the feedback received in response to our survey, we support attention to clearing access for clients. However, it will be very important for FICC (or any other clearing agency that clears UST securities and/or repos in the future) to propose changes to client clearing models for comment and have the opportunity to address comments received before making any changes, as such changes could materially affect the risks and benefits of additional clearing for clearing members and clients.

Many of ISDA's members look forward to engaging with FICC (and any other clearing agencies) on these important issues related to client clearing models for UST securities and repos. We support the proposal's approach of allowing clearing agencies to engage on potential reforms directly with affected market participants via the clearing agencies' existing rulemaking processes, particularly given the many risks involved and given that various models may be appropriate for different firms and different situations. Additionally, we encourage the SEC to allow sufficient time for clearing agencies and market participants to consider and, if appropriate, implement reforms to client clearing models without requiring any additional client clearing before completion of this work. Such sequencing is imperative to allow affected market participants to fully understand and prepare to manage the risks, costs and benefits of clearing under the models that could apply to them.

Responses from ICI, MFA, SIFMA/IIB and SIFMA AMG

Many ISDA members are also members of ICI, MFA, SIFMA/IIB and/or SIFMA AMG and have contributed to these associations' respective responses to the proposal. In order to ensure

[5] FRB Vice Chair for Supervision Barr covered these issues in a recent speech available at https://www.federalreserve.gov/newsevents/speech/barr20221201a.htm.

that any requirements for additional clearing in the UST market can be implemented and operationalized effectively and efficiently across differently situated market participants, we strongly encourage the Commission to consider and address the issues and recommendations raised in these responses, which, among other things, account for the associations' varying constituencies.

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We appreciate the opportunity to submit our response to the proposal. If you have any questions or would like more information, please reach out to Ann Battle, Senior Counsel Market Transitions at abattle@isda.org.

Sincerely,

Ann M Battle

Ann Battle
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International Swaps and Derivatives Association, Inc. (ISDA)