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October 21, 2024

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

**Re: SR-FICC-2024-005 (Clearing Access)**

Dear Ms. Countryman:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on the proposed FICC rule changes (the "Proposed Rules"). These rules are supposed to facilitate client clearing prior to the implementation date of the Commission's clearing mandate for cash and repo transactions in the U.S. Treasury market (the "SEC Clearing Rule").[1] However, as they currently stand, the Proposed Rules will fail to deliver a viable solution for a wide variety of market participants and, accordingly, should be rejected by the Commission as inconsistent with the Exchange Act. Material course corrections are required to ensure a smooth transition to central clearing and to avoid disrupting the most critical capital market in the world.

Our response is informed by the market experience of two separate and distinct businesses – Citadel Securities, a leading global market maker, and Citadel, a leading global alternative investment firm. Across both businesses, we have consistently advocated for modernizing Treasury market structure, including by expanding central clearing, increasing public transparency, and rationalizing trading venue oversight.[2] With respect to central clearing, we have detailed how thoughtfully expanding clearing can deliver significant benefits, including optimizing dealer balance sheet utilization, reducing credit and operational risk, enhancing competition, and fostering innovation in trading protocols.[3]

However, as we move towards the first implementation date of December 2025 under the SEC Clearing Rule, we are increasingly alarmed that central clearing will not be implemented in an optimal manner in the Treasury market. In particular, a wide range of market participants have expressed significant concerns regarding the FICC Proposed Rules,[4] including with respect to

[1] 87 Fed. Reg. 64610 (Oct. 25, 2022).

[2] *See generally*, Citadel Response to the Request for Information on Additional Transparency for Secondary Market Transactions of Treasury Securities (Aug. 31, 2022) available at https://www.regulations.gov/comment/TREAS-DO-2022-0012-0028; Citadel Response to the Request for Information on the Evolution of U.S. Treasury Market Structure (Apr. 22, 2016) available at https://www.treasurydirect.gov/files/laws-and-regulations/gsa/rfi-comments/rfi-comment-letter-citadel.pdf; Remarks by Ken Griffin at the 2015 Roundtable on Treasury Markets and Debt Management (Nov. 20, 2015) available at https://home.treasury.gov/system/files/276/11-20-2015-Ken-Griffin-Treasury-Roundtable-Remarks.pdf.

[3] *See* Citadel comment letter (Dec. 27, 2022), available at: https://www.sec.gov/comments/s7-23-22/s72322-20153723-321373.pdf.

[4] *See, e.g.,* https://www.sec.gov/comments/sr-ficc-2024-005/srficc2024005.htm.

clearing access, margin protection, and default management. Meanwhile, FICC has resisted making material changes to those Proposed Rules; instead wasting precious time attempting to rebut the expressed concerns or promising additional rule changes that may not be finalized before the December 2025 implementation deadline.[5]

The U.S. Treasury market is the deepest and most liquid government securities market in the world and it is critical that the transition to central clearing occurs in a smooth, efficient, and predictable manner. We therefore recommend that the official sector take a more active role in overseeing the industry-led efforts to implement the SEC Clearing Rule, including ensuring that FICC is implementing rules that comply with applicable regulatory requirements.

**The FICC Proposed Rules Do Not Facilitate "Done-Away" Client Clearing, Which Is Essential to the Successful Implementation of Central Clearing in the U.S. Treasury Market**

FICC must ensure that a "done-away" client clearing offering is made available to market participants well in advance of the December 2025 implementation date to comply with the regulatory requirement to "[e]nsure 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."[6]

As countless commenters have explained, the SEC Clearing Rule simply *cannot be implemented* without a "done-away" client clearing offering being available (i.e. the ability for a client to clear a transaction with a clearing member that it has executed with another counterparty).[7] Without a viable "done-away" offering, *all* clients will be compelled to accept bundled execution and clearing services, robbing them of the benefits of choice and competition. Notably, such forced bundling is not permitted in other centrally cleared asset classes.

*Done-Away Clearing in the Cash Market*

A "done-away" client clearing offering is essential to implement the clearing mandate for cash transactions executed on interdealer broker platforms, due to come into effect in December 2025. By definition, each such transaction involving a firm that is not a direct member of a clearinghouse is a "done-away" transaction, since the interdealer broker is the execution counterparty and does not itself offer client clearing services. Thus, a firm that is not a direct clearinghouse member must be able to access a clearing member that will clear transactions executed "away" from that clearing member in order to participate on interdealer broker platforms. This is no small matter, as the interdealer broker platforms typically account for over $500 billion of daily trading activity and more than 50% of total daily volumes in the cash Treasury market.[8] Further, these platforms

[5] *See* FICC Letter (Aug. 1, 2024), available at: https://www.sec.gov/comments/sr-ficc-2024-007/srficc2024007-500915-1465682.pdf ("FICC Response Letter").

[6] Exchange Act Rule 17Aad-22(e)(18).

[7] *See, e.g.,* Letters from AIMA, FIA PTG, and MFA, available at: https://www.sec.gov/comments/sr-ficc-2024-005/srficc2024005.htm.

[8] *See* https://www.finra.org/finra-data/browse-catalog/about-treasury/daily-file.

estimate that approximately half of that activity may be conducted by firms that are not currently direct clearinghouse members.

*Done-Away Clearing in the Repo Market*

A "done-away" client clearing offering is also critical to implementing the market-wide clearing mandate for Treasury repo transactions given the number of covered firms that are not direct members of a clearinghouse, including mutual funds, pension funds, and asset managers. Absent such an offering, each covered firm must establish a separate clearing relationship with each of its executing counterparties. Requiring every firm to use a "done-with" client clearing offering that bundles execution and clearing fragments cleared portfolios, increases cost, complexity, contractual risk and operational risk, and limits choice of, and competition among, trading counterparties. It is also completely unscalable for the $27 trillion (and growing) Treasury market. These outcomes threaten the efficiency and resiliency of the U.S. Treasury market, and are directly inconsistent with the regulatory objectives underpinning the SEC Clearing Rule.

*FICC's Inadequate Response*

Given the above, FICC must ensure that a "done-away" client clearing offering is made available to market participants well in advance of the December 2025 implementation date to comply with the regulatory requirement to "[e]nsure 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."[9]

In response to comments, FICC has made two main arguments. First, FICC asserts that "done-away" client clearing is already available and "a number of market participants are currently clearing done-away Treasury transactions at FICC today."[10] Second, FICC asserts that there are a number of "impediments" that are outside of FICC's control that must be resolved before "done-away" client clearing can be further expanded.[11]

These arguments are inherently contradictory. If there are in fact gating issues that prevent "done-away" clearing from being offered in the scale necessary to implement the SEC Clearing Rule, then the amount of "done-away" clearing already taking place is of little relevance. At the same time, FICC makes no attempt to explain how the purported "impediments" have been overcome by those firms who are currently clearing "done-away" transactions today.

Below, we assess each of the "impediments" identified by FICC and conclude that none of them justify FICC's refusal to take further steps to ensure that clients are not compelled to bundle

[9] Exchange Act Rule 17Aad-22(e)(18).

[10] FICC Response Letter at 7. *See also id.* ("nearly 10% of FICC's Sponsoring Members clear done-away repo transactions through FICC's Sponsored Service") and Making the U.S. Treasury Market Safer for all Participants: How FICC's Open Access Model Promotes Central Clearing," DTCC (October 2021) at 6 ("the vast majority of the $80bn plus of activity that we observe clearing and settling daily through FICC's correspondent clearing and prime broker clearing models follows this "give-up" model").

[11] FICC Response Letter at 9-17.

execution and clearing services in the Treasury market. We note that any suggestion that the need for a viable "done-away" client clearing offering could be obviated by clients simply becoming direct members of a clearinghouse ignores regulatory and market realities, including the way central clearing is accessed in all other asset classes. While direct clearing membership may be an option for a limited number of firms, there are many reasons why the vast majority of firms are not direct clearinghouse members in centrally cleared asset classes, including (i) membership requirements, (ii) default management responsibilities (including potential loss mutualization), and (iii) operational requirements. In addition, the SEC Clearing Rule makes it more difficult for many types of clients to become direct clearinghouse members by needlessly limiting the important inter-affiliate exemption to entities that are banks, broker-dealers, and futures commission merchants.[12]

## A. Evaluating the "Impediments" to Done-Away Clearing Identified by FICC

### *1. FICC's First Inaccurate Claim: Clearing Members Must be Able to Limit a Client's Execution Counterparties*

One of the key benefits of central clearing is that, since market participants no longer have ongoing credit exposure to each other following execution, they are able to trade with a broader range of execution counterparties. This transformation in trading spurs price competition and yields a number of benefits, including narrower bid-ask spreads, improved access to best execution, and increased market depth and liquidity, particularly during periods of market stress. This market evolution can also support the growth of all-to-all trading.[13]

Despite these well-established benefits of central clearing, FICC surprisingly asserts that clearing members may have "important and legitimate reasons" to "limit execution counterparties."[14] According to FICC, those reasons include (i) confirming that "a customer's proposed execution counterparty has an execution or similar agreement in place" with the clearing member and (ii) assessing the impact of the proposed execution counterparty's identity on the clearing member's obligations under FICC's Capped Contingency Liquidity Facility ("CCLF"), which may become relevant in the event of a clearing member default.[15]

The Commission must reject this line of argument in the clearest possible terms. In a cleared market, the identity of a customer's original execution counterparty should be irrelevant to a clearing member because the clearing member is not exposed to the creditworthiness of the execution counterparty. Thus, a clearing member should not be in a position to limit a customer's execution counterparties. Instead, the clearing member should be squarely focused on the risk profile of its own clearing customer and such customer's cleared trading activity (irrespective of

[12] The practical effect of this is that clients exploring direct clearinghouse membership would have to clear transactions entered into between the entity designated as the direct member and other affiliated trading entities, increasing costs and complexity.

[13] *See* Alain Chaboud et. al., "All-to-All Trading in the U.S. Treasury Market," FRBNY (Oct. 2022) available at https://www.newyorkfed.org/research/staff_reports/sr1036.

[14] FICC Response Letter at 17.

[15] *Id.*

with whom the customer is initially executing). This is why the Commodity Futures Trading Commission specifically prohibited the type of trilateral execution agreement described by FICC, stating that it "could lead to undue influence by [clearing members] on a customer's choice of counterparties" and "constrain a customer's opportunity to obtain competitive execution of the trade by limiting the number of potential counterparties."[16] FICC has also failed to explain why the *identity* of a customer's original execution counterparty might be relevant in determining a clearing member's CCLF requirements. The suggestion that executing a cleared trade with one executing firm versus another (assuming that both are "done-away" trades) could lead to different CCLF requirements appears to be unprecedented compared to other cleared asset classes.

2. *FICC's Second Inaccurate Claim: "Done-Away" Transactions Have Greater Liquidity Risks*

Next, FICC claims "done-away" transactions expose FICC to additional "liquidity risks" in the event of a *clearing member* default, leading to higher CCLF requirements being imposed on clearing members for this activity.[17] Specifically, FICC asserts that, in the event of a clearing member default, FICC can immediately close-out both sides of a "done-with" client transaction (since the defaulted clearing member was also the executing counterparty), but likely will be unable to do so for a "done-away" transaction. Thus, FICC may be required to continue to perform obligations with respect to the "done-away" activity of non-defaulting customers of a defaulted clearing member.[18]

This purported distinction only highlights a deficiency with respect to FICC's current default management framework. In the event a clearing member defaults, *all* non-defaulting customers will want the option to avoid immediately having their positions closed-out by FICC (regardless of whether their original execution counterparty was the clearing member or a third-party). It is incumbent on FICC to ensure there is much greater uniformity in terms of how customer transactions are handled in the event of a clearing member default (regardless of the identity of the original execution counterparty), and that non-defaulting customers can continue to settle open positions or port them to another clearing member.

3. *FICC's Third Inaccurate Claim: "Done-Away" Clearing Creates a Number of Unique Challenges*

Finally, FICC alleges several additional "unique" challenges associated with "done-away" clearing:

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[16] 77 Fed. Reg. 21278, 21280 (April 9, 2012), available at: https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2012-7477a.pdf.

[17] FICC Response at 12.

[18] We note that FICC may also be required to perform certain obligations with respect to the proprietary positions of the defaulted clearing member.

- *Additional market infrastructure*

  FICC asserts that more work is required "to develop operational workflows for done-away clearing, so as to facilitate the ability of market participants to use existing cleared derivatives systems to submit Treasury transactions for clearing."[19]

  First, FICC fails to explain why the existing trade submission processes employed by electronic trading platforms in the Treasury market to clear transactions at FICC (including the existing "done-away" activity that FICC has noted) are insufficient. Second, with respect to pre-trade credit checks, we note that (i) solutions already exist at the platform level in the Treasury market, and (ii) while the swaps market is quite unique in terms of utilizing third-party "credit hubs" (e.g. compared to other cleared asset classes, such as equities, options, and futures), this existing infrastructure can be adopted for certain non-order book trading protocols in the Treasury market to the extent clearing members deem necessary. As such, it is unclear what else FICC believes needs to occur here.

- *The allocation of regulatory obligations between clearing members and execution counterparties*

  FICC asserts that clearing members "will need to determine how to allocate responsibility for certain regulatory obligations [. . .] with executing brokers" and cites a letter issued by SEC staff in 1994 relating to the allocation of regulatory obligations between a client's prime broker and executing broker in equities.[20] However, in the equities prime brokerage context, *both* the prime broker and the executing broker are *acting for* the client, and therefore are seeking to allocate the responsibilities associated with that client facilitation activity. In contrast, when a client executes a Treasury transaction with an executing counterparty, both are acting in a principal capacity and are counterparties to the transaction. FICC provides no further detail on precisely which regulatory requirements must be allocated in this context and fails to explain how such (purportedly necessary) allocation has been handled by those market participants clearing "done-away" transactions today.

- *Capital and accounting*

  FICC asserts that clearing members may be subject to greater capital requirements by offering "done-away" clearing "since it may be more difficult for them to conclude that they have a well-founded basis on which they will be able to exercise close-out netting rights upon a customer default" and that "FICC is eager to work with market participants to develop mechanisms to facilitate close-out of done-away."[21] Noting that a clearing member's close-out rights – in the event a customer defaults – are

[19] FICC Response at 10.

[20] FICC Response at 14.

[21] FICC Response at 14.

typically set forth in the bilateral documentation between the clearing member and its client, FICC should provide further detail on the close-out processes being relied upon by those market participants clearing "done-away" transactions today. More generally, while the impact of bank capital requirements (including those both finalized and proposed) bears watching to ensure that client clearing is not disincentivized, we are not aware of the relevant rules seeking to distinguish between "done-with" and "done-away" clearing in terms of their application, particularly given the widespread use of "done-away" clearing in other asset classes.

In addition, FICC notes that "done-away clearing may present accounting considerations that done-with transactions do not."[22] In connection with this statement, FICC should provide further transparency on the accounting treatment of all of its various client clearing models (including whether the Sponsored Model has different accounting treatment than the Agency Clearing Model) and the outstanding questions that remain to be addressed. FICC has separately noted that the Sponsored Model has "more settled regulatory considerations and accounting treatment,"[23] but has not clarified whether such "settled" accounting treatment applies equally to "done-with" and "done-away" clearing and the segregated and non-segregated client margin options under the Sponsored Model.

### B. FICC Should Take Further Steps to Ensure Clients Are Not Compelled to Bundle Execution and Clearing

As detailed above, an end-state where *all* customers are required to accept bundled execution and clearing services in order to participate in the U.S. Treasury market will not lead to the successful implementation of the SEC Clearing Rule, and could have negative consequences for Treasury market liquidity, efficiency, and resiliency. Therefore, consistent with regulatory requirements to facilitate indirect access, prohibit anti-competitive practices, and mitigate conflicts of interest, FICC should prohibit clearing members from compelling clients to bundle execution and clearing.

Commission regulations specifically require that FICC "[e]nsure 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."[24] In addition, the Exchange Act expressly requires that FICC's rules "protect investors and the public interest," prevent "unfair discrimination [. . .] among participants in the use of the clearing agency," and not "impose any burden on competition not necessary or appropriate."[25] The Commission has also taken steps to mitigate potential conflicts of interest at clearing agencies "between owners and

[22] *Id.*

[23] FICC Response at 20.

[24] Exchange Act Rule 17Aad-22(e)(18).

[25] Exchange Act Sections 17A(b)(3)(F) and Section 17A(b)(3)(I). *See also* Exchange Act Rule 17ad-22(e)(18)(i) requiring "fair and open access by direct and, where relevant, indirect participants."

participants, large and small participants, and direct and indirect participants."[26] Given this regulatory backdrop, and the fact that a viable "done-away" clearing offering is necessary for clients to comply with the SEC Clearing Rule, the Proposed Rules fall far short of what is required by the Exchange Act. Importantly, the same firms that serve as FICC sponsoring clearing members for clients provide full-service "done-away" clearing offerings in every other centrally cleared asset class, including equities, options, futures, and swaps. There is nothing unique about the Treasury market that explains why the largest clearing members are not clearing "done-away" transactions at FICC; instead, FICC has not taken the steps necessary to ensure this market evolution.

FICC's remaining arguments are unavailing. First, FICC mischaracterizes prohibiting the anti-competitive practice of forced bundling as constituting a "done-away mandate."[27] This is inaccurate, as the proposed prohibition would not require a clearing member to offer "done-away" client clearing or prevent clients from electing to bundle services if they so choose. Instead, to the extent a clearing member elects to offer client clearing, it simply cannot force *all* of its clients to bundle execution and clearing.

Second, FICC claims that it lacks the statutory authority to prohibit this anti-competitive practice, suggesting that this would constitute price fixing in violation of the Exchange Act.[28] But simply prohibiting a clearing member from compelling all of its clients to bundle execution and clearing does not dictate how a clearing member may charge for the different services it offers. FICC also argues that a prohibition on forced bundling may be characterized as the clearing agency improperly "prohibit[ing] or limit[ing] access by any person to services offered therein."[29] In practice, however, it is the existing practice of forced bundling that limits client access to the clearing services necessary to comply with the SEC Clearing Rule; the proposed prohibition would simply broaden the clearing offerings made available to clients.

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We have been a longstanding advocate for measures to enhance the efficiency, liquidity, and resiliency of the Treasury market, including through the expansion of central clearing. As demonstrated by experience in other asset classes, market-wide clearing with fair and open access should be expected to improve market liquidity and resiliency. However, failing to implement the SEC Clearing Rule in a sensible manner, including with respect to client clearing services and overall market competition, could materially harm the functioning of the U.S. Treasury market. As such, we recommend that the Commission reject FICC's Proposed Rules as inconsistent with the Exchange Act and that the official sector take a more active role in overseeing the industry-led efforts to implement the SEC Clearing Rule.

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[26] 88 FR 84454 (Dec. 5, 2023) at FN 113, available at: https://www.govinfo.gov/content/pkg/FR-2023-12-05/pdf/2023-25807.pdf.

[27] FICC Response Letter at 10-16.

[28] *Id*. at 15.

[29] *Id.* at 16.

Please feel free to contact the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy