ISDA Safe, Efficient Markets

July 22, 2024

Submitted Electronically

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

Re: ***SEC "Notice of Filing of Proposed Rule Change To Modify the GSD Rules Relating to the Adoption of a Trade Submission Requirement" [Release No. 34-100417; File No. SR-FICC-2024-009]***

Dear Ms. Countryman:

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] respectfully submits this comment letter to the Securities and Exchange Commission (the "**Commission**" or the "**SEC**") in response to the Fixed Income Clearing Corporation's ("**FICC**") recently published proposed rule changes. This comment letter addresses FICC's proposal to modify its Government Securities Division Rulebook ("**FICC Rules**")[2] in accordance with the Securities Exchange Act of 1934, as amended ("**Exchange Act**" or the "**Act**") to (i) adopt a requirement that each Netting Member must submit all eligible secondary market transactions ("**ESMTs**") to which it is a counterparty to FICC for clearance and settlement, (ii) adopt new initial and ongoing membership requirements and other measures to facilitate FICC's ability to monitor a Netting Members' compliance with the trade submission requirement, (iii) adopt fines and other disciplinary measures to address a Netting Member's failure to comply with the trade submission requirement, and (iv) otherwise modify the FICC Rules to facilitate the trade submission requirement (the "**Proposal**").[3]

Terms used but not defined have the meaning provided in the FICC Rules or in the Proposal.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 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, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on ISDA's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

[2] FIXED INCOME CLEARING CORP., FIXED INCOME CLEARING CORPORATION GOVERNMENT SECURITIES DIVISION RULEBOOK (Dec. 4, 2023), https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.

[3] FICC Notice of Filing of Proposed Rule Change to Modify the GSD Rules Relating to the Adoption of a Trade Submission Requirement, 89 Fed. Reg. 54,602 (July 1, 2024) [hereinafter cited to as "Proposal"].

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I. The Proposal's Requirement That Netting Members Submit to FICC for Novation All ESMTs To Which Such Netting Member Is a Counterparty Is Anticompetitive as Drafted.

Rule 5 of the Proposal requires Netting Members to submit all of their ESMTs *only* to FICC for clearance and settlement and is anti-competitive on its face. Specifically, Rule 5 provides that "Netting Members shall submit to [FICC] for Novation all [ESMTs] … to which such Netting Member is a counterparty."[4] The Proposal does not contemplate the existence of another clearing agency clearing U.S. Treasury securities, even though the SEC's final U.S. Treasury clearing rules (the "**Treasury Clearing Rules**") apply generally to all covered clearing agencies that provide central counterparty services for U.S. Treasury securities.[5]

The absolute requirement that Netting Members submit all eligible ESMTs to FICC for Novation without exception is contrary to the Exchange Act, which not only directs the SEC to facilitate the establishment of a clearance and settlement system, "having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents,"[6] but also provides that the rules of clearing agencies shall "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]."[7] Moreover, the Exchange Act itself clearly contemplates the future existence of other clearing agencies outside of FICC by way of its general definition of a "clearing agency" and the SEC's own acknowledgement that other clearing agencies may come to be registered by the SEC.[8]

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[4] FIXED INCOME CLEARING CORP., Modify the GSD Rules Relating to the Adoption of a Trade Submission Requirement (Form 19-b4), Exhibit 5 at 128 (June 12, 2024) (available at https://www.dtcc.com/-/media/Files/Downloads/legal/rule-filings/2024/FICC/SR-FICC-2024-009.pdf).

[5] *See generally* 17 C.F.R. § 240.17ad-22 and SECURITIES AND EXCHANGE COMMISSION, 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, 89 Fed. Reg. 2,714 at 2,823 (Jan. 16, 2024).

[6] 15 U.S.C. § 78q–1(a)(2) (2024) (emphasis added). The relevant language reads:

> (A) The Commission is directed, therefore, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority under this chapter—(i) to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempt securities); and (ii) to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options; in accordance with the findings and to carry out the objectives set forth in paragraph (1) of this subsection.
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> (B) The Commission shall use its authority under this chapter to assure equal regulation under this chapter of registered clearing agencies and registered transfer agents. In carrying out its responsibilities set forth in subparagraph (A)(ii) of this paragraph, the Commission shall coordinate with the Commodity Futures Trading Commission and consult with the Board of Governors of the Federal Reserve System.

[7] 15 U.S.C. § 78q–1(b)(3)(I) (emphasis added). The relevant language reads: "(3) A clearing agency shall not be registered unless the Commission determines that—(I) The rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."

[8] *See id.*; 17 C.F.R. § 240.17ad–22(e) (2024) (which speaks of "each covered clearing agency"); 17 C.F.R. § 240.17ad–22(e)(6) (2024) (which speaks of central counterparty services for U.S. Treasury securities specifically).

While there are currently no other clearing agencies registered with the SEC, both ICE Clear Credit LLC and CME Group Inc. have announced their desire to provide clearing services in the near future.[9] It would be inefficient and a barrier to competition to wait until other clearing agencies begin offering U.S. Treasury securities clearing services; updating the FICC Rules later to account for additional clearing agencies will take time (e.g., FICC will need to amend its rules and submit a Rule 19b-4 filing), and will require accounting for additional complexities, some of which we preview in this letter. Adopting required changes at a later time will leave market participants unable to readily take advantage of the opportunity to broaden their U.S. Treasury securities clearing access and any concomitant pricing, diversification, regulatory or other benefits since doing so would violate the FICC Rules. Further, this would contradict the Exchange Act's public policy goals of promoting the "prompt and accurate clearance and settlement of securities transactions" and avoiding "inefficient procedures for clearance and settlement [that] impose unnecessary costs."[10] As such, ISDA implores FICC to resolve this issue now to avoid causing market disruption and confusion amongst Netting Members.

Critically, ISDA believes that FICC must also perform a holistic review of its entire rulebook to identify and remediate any legacy rules or newly proposed rules that are anticompetitive or do not work properly in a multi-clearing agency environment. For example, Section 7(e) of Rule 2A of the FICC Rules pertaining to submission of trade data for all eligible trades done with other Netting Members should be modified to consider that other clearing agencies may clear U.S. Treasury securities in the future.[11] Moreover, multiple clearing agencies should not assess penalties for failure to comply with the trade submission requirement for the same clearable trade, and, accordingly, the concept of penalties for failure to clear must be holistically rethought. While these are just two instances where such changes are necessary, other rules will likely need updating to account for future clearing agencies or to be made clearing agency agnostic.

For these reasons, ISDA requests that (1) FICC revise Rule 5 to make clear that its Netting Members may clear U.S. Treasury securities with other clearing agencies without violating the FICC Rules, and (2) eliminate any other FICC Rules that implicate anticompetitive concerns and change the FICC Rules in a manner that accommodates the presence of more than one clearing agency.

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[9] *See*, e.g., Katherine Doherty, *ICE Moves to Clear U.S. Treasuries as Market Regulation Expands*, (June 24, 2024, 12:01 AM EDT updated at 9:40 AM EDT), https://www.bloomberg.com/news/articles/2024-06-24/ice-moves-to-clear-us-treasuries-as-market-regulation-expands?embedded-checkout=true; Reuters, *CME Group Bids to Enter US Treasuries Clearing Business*, (Mar. 12, 2024, 9:47 PM EDT), https://www.reuters.com/markets/us/cme-group-bids-enter-us-treasuries-clearing-business-financial-times-reports-2024-03-12/.

[10] 15 U.S.C. § 78q–1(a)(1)(A)-(B).

[11] FIXED INCOME CLEARING CORP., *supra* n. 2 at 86.

II. The Triennial Independent Trade Submission Review and Report Should Be Eliminated.

ISDA members have serious concerns with the proposed Triennial Independent Trade Submission Review and Report (the "**Triennial Review**").[12] As discussed in further detail below, the Triennial Review is redundant with other requirements and provisions set out in the Proposal while adding no clear benefit to FICC. ISDA believes that the Triennial Review is not only excessive in the overall context of the Proposal but also would create unnecessary costs for Netting Members. Disclosure to third parties of trade data in connection with the Triennial Review would also put at risk Netting Members' obligations to protect that data. For these reasons, as further explained below, ISDA members request that FICC eliminate the Triennial Review in the final FICC Rules.

(a) The Triennial Review Is Redundant with Other Proposal Requirements and Provisions.

The Triennial Review is redundant with FICC's other proposed compliance requirements and authority to request information from Netting Members. For example, both the Triennial Review and a separate Annual Trade Submission Attestation ("**Annual Attestation**")[13] require Netting Members to indicate that they have complied with the trade submission requirement during overlapping review periods because there is no exception from the Annual Attestation during a Triennial Review period. In addition, under the Proposal, FICC's compliance obligations are triplicated because FICC would mandate—year-round—that Netting Members notify FICC, in writing, within two Business Days from the date on which a Netting Member learns that it is no longer in compliance with the trade submission rules ("**Ad Hoc Notification of Trade Submission Failure**").[14] ISDA is confounded as to what benefit FICC believes such excessive reporting would provide.

In addition to these frequent reporting obligations, the Proposal provides FICC with the discretion to request annual audited financial statements from Netting Members and their Affiliates.[15] The Proposal would also formally adopt the annual due diligence requirement that FICC currently asks Netting Members to complete and makes clear that FICC may inspect the books and records of each Netting Member to ensure compliance with the trade submission rules.[16] FICC has granted itself exceptionally broad authority to request and thoroughly examine each Netting Member's (and in some cases, its Affiliates')[17] internal procedures. If Netting Members are required to provide Annual Attestations, abide with the Ad Hoc Notification of Trade Submission Failure, provide FICC access to their books and records, answer diligence questions, and provide financial statements on demand, it is again unclear to ISDA members what further benefit FICC will receive in having Netting Members also conduct a Triennial Review.

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[12] *See* FIXED INCOME CLEARING CORP., *supra* n. 4 at 114-115 (the Triennial Review is set out in proposed Rule 3, Section 2(iii)(c)(2)).

[13] *See id*. at 113-114 (the Annual Review is set out in proposed Rule 3, Section 2(iii)(c)(1)).

[14] *See id*. at 129 (proposed Rule 5, Section 2(b)).

[15] *See id*. at 111 (proposed Rule 3, Section 2(i)).

[16] *See id*. at 129.

[17] *See id*. at 105-106 (proposed Rule 2A, Section 5(b)) and 111 (proposed Rule 3, Section 2).

While ISDA understands FICC's need to implement rules allowing it to oversee adherence to the trade submission requirement, FICC has clearly overshot any applicable monitoring requirements through its multiple and myriad layering of reporting and compliance obligations in the Proposal. ISDA members, therefore, urge FICC to eliminate the Triennial Review in its entirety from the final FICC Rules given that it is redundant with other proposed requirements and imposes overlapping compliance burdens on Netting Members without commensurate benefit to regulatory oversight.

(b) The Triennial Review Is Overly Burdensome, Creates Excessive Financial Burdens for Netting Members, Undermines Netting Members' Obligations to Safekeep Trade Data and Is Not Justifiable Under a Cost-Benefit Analysis.

Practical concerns with respect to the Triennial Review further justify its removal. For example, ISDA members are concerned with the Proposal's mandate that the Triennial Review be conducted by either an independent third party, approved by FICC, or an independent internal audit function reporting directly to the Netting Member's board of directors or equivalent most senior body (**"Board"**) or Board-designated committee.[18] For many Netting Members, particularly smaller ones, an independent internal audit may be unworkable and is inflexible. On the other hand, using a FICC-approved independent third party to complete the Triennial Review is equally not feasible. This requirement would impose a heavy financial burden, requiring the hiring of independent consultants that FICC has authorized to complete the Triennial Review every three years. ISDA also foresees capacity issues with the service providers since all Netting Members would need to retain the same FICC-approved providers at the same time. Critically, the quantity of confidential and proprietary trade data that Netting Members would be required to disclose to third parties is also seriously concerning. ISDA members worry that this requirement was not thoughtfully considered as FICC did not provide a rationale underlying its third-party approval rights.

There is further concern over the sheer volume of three years' worth of data required to be audited in connection with the Triennial Review to show compliance with the trade submission requirement. The amount of data that will need to be collected and analyzed will require substantial resources and be overly burdensome for Netting Members. FICC has not explained how it plans to validate the data to ensure compliance with the trade submission requirement. In practice, there would need to be a realistic, standardized framework in place to undertake such a vast exercise. As proposed, the Proposal leaves too much room for discrepancy – not just in how Netting Members would undertake data collection, but also in how an internal audit function or independent third parties would conduct their review.

Because it is unprecedented for a clearing agency to impose this extent of monitoring, ISDA believes that FICC has an obligation, which it has not met, to show that these rules are consistent with the Exchange Act, i.e., that they are not "inefficient", do not "impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors,"[19] and "have

[18] *See id*. at 114 (proposed Rule 3, Section 2(iii)(c)(2)(i)-(ii)).

[19] 15 U.S.C. § 78q–1(a)(1)(B); *See also* 17 C.F.R. § 240.17ad-22(e)(21) ("Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable … [b]e efficient and effective in meeting the requirements of its participants and the markets it serves …").

due regard for the public interest."[20] Neither FICC nor the Commission have evaluated the burden of complying with such extensive and redundant reporting requirements and considered how to streamline them, which ISDA believes can best be done by eliminating the Triennial Review. The Commission's own rulemaking process provides that a proposed rule's potential benefits and costs should be thoughtfully considered when making a reasoned determination that adopting a rule is in the public interest.[21] The Commission should not approve a proposed rule that is not in keeping with its own standards.[22] While the Commission noted in its Federal Register publication of the Treasury Clearing Rules that it had received no comments on the burden estimates provided in its proposal in monitoring for compliance with the trade submission requirement,[23] it was unknown at that time what FICC would actually propose, much less that FICC would mandate a redundant Triennial Review. ISDA members believe that reconsideration of the costs and benefits associated with the proposed monitoring requirements would clearly show that the costs of the Triennial Review outweigh its benefit.

While ISDA members appreciate the importance of FICC's monitoring compliance with the Treasury Clearing Rules, the Triennial Review is too onerous and impractical with little to no upside. For each of the above-mentioned reasons, ISDA encourages FICC to eliminate the Triennial Review from the final FICC Rules.

III. The Annual Attestation Requirement Should Allow for More Flexibility.

FICC should reconsider its approach to the Annual Attestation to make this requirement more flexible and clearing agency agnostic. The Proposal requires that Netting Members provide FICC with an Annual Attestation regarding their ongoing compliance with the trade submission requirement in a form prescribed by FICC.[24] However, the contents of this Annual Attestation are overly prescriptive and may be impossible to meet. For instance, attesting to having complied with the trade submission requirement "at all times"[25] would be impossible without qualification whenever any, even de minimis, trade submission failures were noticed during the 12-month period. The Annual Attestation should instead allow Netting Members to disclose any material issues of noncompliance experienced during the year, along with process improvements undertaken in response. Further, the Attestation Requirement should focus on whether Netting Members have reasonably designed policies and procedures to prevent a material violation of the trade submission requirement and, to the extent that a material violation of the trade submission

[20] 15 U.S.C. § 78q–1(a)(2)(A); *See also* 17 C.F.R. § 240.17ad-22(e)(2)(iii) ("Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable … (iii) Support the public interest requirements in Section 17A of the Act (15 U.S.C. 78q–1) applicable to clearing agencies, and the objectives of owners and participants.").

[21] *See generally* Memorandum from the Office of the General Counsel and the Division of Risk, Strategy, and Financial Innovation (RSFI) and the Office of the General Counsel (OGC) Regarding Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012) (Last Reviewed or Updated: June 6, 2024) (on file with the SEC).

[22] "High-quality economic analysis is an essential part of SEC rulemaking." *Id.* at 1.

[23] *See* SECURITIES AND EXCHANGE COMMISSION, *supra* n. 5 at 2,823.

[24] FIXED INCOME CLEARING CORP., *supra* n. 4, at 113-114 (Rule 3, Section 2(iii)(c)(1)).

[25] *Id*. at 114.

requirement occurred, have updated their policies and procedures as necessary to prevent future violations. This approach is consistent with other SEC compliance program requirements.[26] Moreover, this type of attestation would be clearing agency agnostic and compatible with the existence of multiple clearing agencies.

In addition, FICC should provide flexibility as to the signatory of the Annual Attestation. The Annual Attestation is required to be signed by the Netting Member's Chief Compliance Office ("**CCO"**) or most senior authorized officer of the Netting Member who performs a similar function.[27] The CCO or equivalent "most senior officer" may not be the most appropriate person to sign an Annual Attestation of this nature. Netting Members with large-scale operations may have CCOs that monitor the firm's compliance at the highest-levels, and accordingly, may not have the requisite day-to-day experience or exposure to the firm's clearing operations, let alone clearing for ESMTs specifically. In such a case, it may be more appropriate to have someone closer to and more familiar with the Netting Members' clearing operations provide the attestation. Alternatively, a Netting Member may have more than one CCO responsible for different aspects of the Netting Member's business or in accordance with various regulatory requirements. In such an instance, it would be unclear which of the CCOs would need to provide the attestation. Moreover, in the case of entities with a variety of business lines and geographically dispersed operations, it may be appropriate to focus on personnel in the U.S. region or the clearing business, rather than a global officer. Accordingly, ISDA members believe that the current requirement is too prescriptive and provides a one-size-fits-all approach which is not appropriate given the various structural and operational differences between Netting Members. Rather, the criteria and content of the attestation should drive the determination of its signatories. For these reasons, FICC should make the Annual Attestation requirement more flexible by enabling Netting Members to designate a signatory best suited to attest to the Netting Members' compliance with FICC's rules.

IV. The Proposed Ad Hoc Notification of Trade Submission Failure Must Be Refined.

FICC should tailor the Ad Hoc Notification of Trade Submission Failure to require notice only of material noncompliance issues. As proposed, Section 2(b) of Rule 5 would require a Netting Member to notify FICC, in writing, within two Business Days from the date on which it learns that it is no longer in compliance with the trade submission requirement.[28] The Ad Hoc Notification of Trade Submission Failure is quite broad, with no apparent limitation on notifications of immaterial issues. The notification is novel in that other central clearing counterparties do not require such granular notifications. Moreover, the cost of providing notice of any failure to clear a trade, including clerical errors or minor oversights, is burdensome. While ISDA appreciates that the SEC has imposed a monitoring requirement on clearing agencies that offer U.S. Treasury securities clearing, notices of single failures are costly and not meaningful. Instead, frequent notices of clearing issues would create noise, preventing FICC from delineating between concerns that are not meaningful and those that are material and affect the integrity of the clearing agency. Like

[26] *See e.g.*, 17 C.F.R. § 240.15Fh-3 (relating to business conduct rules for security-based swap dealers) and 17 C.F.R. § 240.15Fi-5 (relating to security-based swap trading relationship documentation).

[27] *See id*. at 113.

[28] *See id*. at 129.

other noncompliance reporting requirements (such as the annual CCO report), FICC needs to add a materiality standard and carveout for failures addressed in a timely manner. By doing so, the Ad Hoc Notification of Trade Submission Failure would provide greater value to FICC and prevent such notifications from becoming a drag on Netting Members' day-to-day operations, needlessly consuming resources for single failures or other nonmaterial issues.

Further, the Ad Hoc Notification of Trade Submission Failure's two-Business Day requirement is too short and is inconsistent with similar requirements imposed on Netting Members by other regulatory authorities. For example, under FINRA Rule 4530 members have thirty calendar days (versus the Proposal's two Business Days) to report, amongst other things, a violation of the rules of any self-regulatory organization.[29] Netting Members are already familiar with these requirements and have internal processes in place designed to timely comply with those reporting requirements. Moreover, giving Netting Members only two Business Days to notify FICC of non-compliance with details concerning the duration of non-compliance, remedial action taken and contact information for the Netting Member's management team overseeing the matter[30] presents a highly challenging timeframe for compliance. FICC should align its Ad Hoc Notification of Trade Submission Failure requirements with those that are already in place for other regulatory regimes to ensure a pragmatic, consistent and efficient reporting process industry wide.

FICC should also reconsider the general framework of the Ad Hoc Notification of Trade Submission Failure to reflect the possibility of multiple clearing agencies. Specifically, FICC should provide that notifications to FICC are only mandated when a Netting Member's violation relates to trades at FICC. If Netting Members engage with other clearing agencies in the future, they should not have to notify FICC of violations with respect those trades for which FICC is not responsible for clearing or monitoring for compliance.

ISDA members recognize their responsibility as Netting Members to report non-compliance; however, FICC's proposed Ad Hoc Notification of Trade Submission Failure needs modification to be workable.

V. The Proposal Must Be Revised to Reference the Actual Trade Submission Requirement Deadlines for Cash and Repo Trades and Include a Process for Possible Future Clearing Mandates for U.S. Treasury Securities, Thereby Avoiding Unintended Springing Effective Dates.

The Proposal needs to be revised to state expressly that the trade submission rules will only become effective in accordance with the Treasury Clearing Rules (December 31, 2025, for cash trades and June 30, 2026, for repo trades).[31] The preamble to the Proposal does note this but the Proposal itself does not, leaving it ambiguous in this regard. In fact, the Proposal confusingly states before each new proposed Rule, "[t]hese changes have been approved by the SEC but have not yet been implemented. By no later than March 31, 2025, these changes will be implemented, and this legend

[29] *See* FIN. INDUS. REG. AUTH., FINRA RULES, R. 4530(a) (available at https://www.finra.org/rules-guidance/rulebooks/finra-rules) (last visited July 19, 2024).

[30] *See* FIXED INCOME CLEARING CORP., *supra* n. 4, at 129 (proposed Rule 5, Section 2(b)).

[31] *See* SECURITIES AND EXCHANGE COMMISSION, *supra* n. 5 at 2,770.

will automatically be removed from this Rule."[32] Rules for separation of house and customer margin, access to clearance and settlement services, and the customer protection rule do need to be effective on March 31, 2025.[33] However, the trade submission component should be voluntary prior to the later applicable deadlines of December 31, 2025, and June 30, 2026. FICC should clarify that Netting Members do not need to comply with the trade submission component of the Treasury Clearing Rules prior to the actual applicable effective dates so that Netting Members can work on documentation and other compliance efforts, the timeline for which is already challenging.

To complicate matters further, it is not currently clear which types of repos in U.S. Treasury repo securities are actually subject to the trade submission requirement since the Treasury Clearing Rules defer to whether a clearing agency is able to provide central counterparty services for various types of repo trades in U.S. Treasury securities.[34] Nothing is written in the Proposal stating which types are covered. Market participants now must simply make an educated guess as to which repo trades FICC is able to clear and thus which are subject to the clearing mandate. This lack of clear guidance on which repo trades a clearing agency can clear, and which therefore must be cleared, is untenable in the long term, particularly as other clearing agencies begin to develop U.S. Treasury security clearing capabilities.

Not only should the FICC Rules be explicitly clear on the types of trades that are required to be cleared, but there should also be procedural safeguards surrounding FICC's (or a clearing agency's) ability to offer clearing for new products that would be subject to the clearing mandate. Specifically, the Proposal's definition of ESMT should make clear that any trade submission requirement for new types of eligible trades (e.g., evergreen or floating repos) to the FICC Rules will be subject to procedural protections, including notice by the clearing agency, public comment and delayed effectiveness. A process should be implemented that is, at a minimum, akin to what already exists under the Commodity Futures Trading Commission's ("**CFTC**") and the SEC's made-available-to-trade ("**MAT**") determinations for cleared swaps and security-based swaps, respectively. Such a process must, however, also incorporate a Commission-led mandatory notice and comment rulemaking process, rather than leaving the determination to a particular clearing agency, and delayed effectiveness, beyond the 30 days applicable to MAT determinations in the cleared swap and security-based swap context, to allow for market adaptation.[35]
Absent any procedural safeguards, a springing mandate will leave Netting Members without time to build their operational systems, undergo necessary internal analysis and enter into documentation to cover new future trade submission requirements. At a minimum, Netting

[32] *See e.g.,* FIXED INCOME CLEARING CORP., *supra* n. 4, at 97 (Rule 1).

[33] *See* SECURITIES AND EXCHANGE COMMISSION, *supra* n. 5 at 2,770.

[34] *See id*. at 2,830 ("(iv) When the covered clearing agency provides central counterparty services for transactions in U.S. Treasury securities, (A) Require that any direct participant of such covered clearing agency submit for clearance and settlement all of the eligible secondary market transactions to which such direct participant is a counterparty")

[35] *See* 17 CFR §§ 37.10, 40.5 and 40.6; 17 CFR §§ 242.806, 242.807 and 242.816 (requiring a filing with the relevant agency and the following of a made-available-to-trade determination process). *See also* Bella Rozenberg, ISDA Comment Letter on Rules Relating to Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities [Release No. 34-94615; File No. S7-14-22] (June 10, 2022) (available at https://www.isda.org/a/2RagE/ISDA-Response-to-SBSEF-Proposal-061022.pdf).

Members would need notice and time to test a roll-out of additional eligible trades before such a mandate were to become effective.

VI. ISDA Remains Concerned About the Workability of the Inter-Affiliate Clearing Exemption and the Requirement to Clear Certain Tri-Party Trades.[36]

ISDA members remain concerned that the inter-affiliate clearing exemption in the Treasury Clearing Rules does not leave sufficient flexibility for a Direct Participant and its affiliates to conduct U.S. Treasury security, liquidity, collateral management, or cash trades within their corporate group, which can have little to do with client-facing trades. The Proposal exempts from its definition of ESMTs the clearing of inter-affiliate Repo Transactions between a FICC Direct Participant and certain of its affiliates only if all of the affiliate's outward-facing trades are cleared.[37] While ISDA members appreciate the exclusion of U.S. Treasury security Repo Transactions between Netting Members and Affiliated Counterparties, ISDA has argued that the exclusion should be broader and cover cash transactions, all affiliates, and provide the exemptions from the outward-facing trade clearing requirement noted above. ISDA continues to encourage FICC to be proactive in working with the SEC to provide, guidance and clarification on this exemption and stands ready to assist in any way.

Further, the Proposal defines a "Treasury Repo Transaction" as a Repo Transaction collateralized by Eligible Treasury Securities. This definition picks up tri-party repos by virtue of the lack of an express carve-out to the contrary. As such, ISDA members who are Direct Participants of FICC continue to be concerned about the requirement to centrally clear tri-party repos that have U.S. Treasury securities at the outset of the trade. ISDA again requests that FICC make clear in the Rules that U.S. Treasury securities do not have to be cleared if they are initially part of a pool of tri-party repo collateral that contains other securities with mixed CUSIPs, whether or not consisting of Eligible Securities. ISDA understands that it is not workable to clear only the U.S. Treasury securities portion of that tri-party repo trade and further does not believe that the clearing mandate should be expanded to other Eligible Securities that are not U.S. Treasury securities. If clearing were nonetheless to be required, market participants would likely substitute cash in lieu of U.S. Treasury securities, which could have a liquidity impact on the market that should be evaluated before imposing broader clearing requirements on market participants. In addition, under a cost-benefit analysis, it would be appropriate in certain instances to exclude tri-party repo trades that contain U.S. Treasury securities as part of a pool at the outset (*e.g.*, where U.S. Treasury securities are initially only a de minimis part of a tri-party trade).

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[36] ISDA first expressed its concerns on this matter in its comment letter in response to the initial publication of the Access Proposal and Segregation Proposal in the Federal Register. *See* Katherine Darras, ISDA Comment Letter (Apr. 17, 2024), https://www.sec.gov/comments/sr-ficc-2024-005/srficc2024005-459631-1194255.pdf.

[37] Inexplicably and likely erroneously, the Treasury Clearing Rules only allowed this exemption for Affiliated counterparties that are banks, brokers, dealers or futures commission merchants. The Proposal defines Affiliated Counterparty in the same way as the Treasury Clearing Rules, but, in an implicit recognition of the over-restrictiveness of this term, FICC leaves open the possibility of amendment to the Treasury Clearing Rules ("The term "Affiliated Counterparty" means, for purposes of the definition of an Eligible Secondary Market Transaction," any counterparty that meets the following criteria, *or as otherwise may be provided for by the SEC pursuant to the Exchange Act* . . ." (emphasis added)). FIXED INCOME CLEARING CORP., *supra* n. 4, at 97 (Rule 1, Definitions).

ISDA looks forward to continued engagement with FICC and the SEC on these issues.

VII. FICC Needs to Significantly Narrow and Clarify Ongoing Membership Requirements.

The Proposal introduces a number of additional requirements for new applicants. It is unclear the extent to which these new requirements would apply to existing Netting Members, as FICC's rulebook currently requires that eligibility and qualifications for new members "must be met at all times" while a Netting Member.[38] We are concerned with both the extent to which FICC may require existing Netting Members to meet the demands of these new requirements, or in the future, continue to impose additional new member requirements that would retroactively apply to existing members.

To complicate matters further, some new applicant requirements call for a subjective assessment by FICC as to what "may impact the suitability"[39] of an applicant, while others are entirely at the discretion of FICC, and it is also not clear how an existing Netting Member would be asked to meet those on a going-forward basis. As one example, FICC has proposed that prospective Netting Members submit business plans, with FICC having the discretion not only to reject such plans but to require such prospective members to pay for an independent consultant to review them and bring them in line with a plan that FICC can approve.[40] Such subjective standards would be impossible to meet on an ongoing basis, since they cannot be foretold, much less be notified to FICC within two Business Days of noncompliance, as the Proposal currently requires.[41] Rather, only well understood capital and liquidity standards should qualify as ongoing standards that existing members must meet, and on which failures must be notified to FICC.

The Proposal also permits FICC to deny netting membership where personnel in senior management roles do not possess the appropriate "industry experience" and "history of compliance."[42] While it is appropriate to ensure that new Netting Members have senior management personnel with relevant expertise, it is unclear whether this would translate to an ongoing requirement and what standard would be applied.

To avoid confusion, and unnecessary costs and compliance burdens for existing Netting Members, FICC should explicitly clarify and delineate the new applicant requirements which do not carry over as ongoing memberships standards in its rulebook.

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[38] *Id*. at 110 (Rule 3, Section 1), further providing: "The eligibility, qualifications and standards set forth in Rule 2A in respect of an applicant shall continue to be met upon an applicant's admission as a Member and at all times while a Member." In addition, Section 7(a) of Rule 3 requires a Netting Member to notify FICC when it no longer complies with relevant qualifications for admission to membership. *See id*. at 118-119. However, FICC is proposing significant changes to these admission qualifications for new Netting Members that existing Netting Members would not have had to satisfy. Thus, it's unclear whether FICC expects existing Netting Members to provide such notice.

[39] *Id*. at 108 (Rule 2A, Section 6).

[40] *See id*. at 105 (Rule 2A, Section 4(d)).

[41] *See id.* at 118-119 (Rule 5, Section 7(a)).

[42] *Id*. at 105 (Rule 2A, Section 4(d)).

Moreover, ISDA members are concerned with FICC's ability to demand information regarding Members (which term includes Sponsored Members as well as Netting Members) and their Affiliates without procedural safeguards and without a compelling reason why this information is necessary. For example, the Proposal would require a Member, at FICC's discretion, to submit annual audited financial statements for any Affiliate of the Member, including an Affiliate that is a non-U.S. organized entity, and would leave it to FICC's "sole discretion" whether to accept unaudited financial statements if audited ones are not available. [43] FICC would also be empowered to require opinions, certificates or other attestations.[44]

ISDA requests that FICC review its expanded standards for existing Members (including Sponsored Members) and revise them to be consistent with industry practices, which do not give this type of unrestrained authority to a self-regulatory organization.

VIII. FICC's Proposed Penalty Schedules Should Be Revised to Account for Netting Member's Good Faith Remedial Efforts.

FICC needs to refine its newly introduced penalties to account for the time-consuming work that often goes into remediating instances of non-compliance. To thoroughly research and understand the root cause of non-compliance takes time. Notwithstanding that a Netting Member may be working in good faith over a number of months to correct an issue, the Proposal contemplates implementing a repeated penalty every ten to thirty days (depending on the issue) until full resolution of the instance of non-compliance.[45] This presents a highly challenging timeframe for remediation and may result in a disproportionately harsh outcome in instances where a Netting Member is actively remediating the violation. Furthermore, a Netting Member may need a reasonable period of time for testing any potential correction to ensure that it does not unintentionally disturb other related processes.

ISDA appreciates that penalties can help prevent rule violations and believes that Netting Members will make a good faith attempt to comply with any compliance obligations that FICC ultimately adopts. However, the proposed penalties should be reserved for the most serious issues where a Netting Member's remediation efforts are significantly below industry standards. Otherwise, a Netting Member could be penalized merely for filing the Ad Hoc Notification of Trade Submission Failure in compliance with FICC's rules.

ISDA members suggest that FICC allow Netting Members the opportunity to (i) initially notify FICC of non-compliance, then (ii) work to remediate the issue that may have caused the non-

[43] *Id*. at 111 (Rule 3, Section 2(i)).

[44] *See id*. at 12 (Rule 3, Section 2(iii)).

[45] Penalties for noncompliance include: (1) $10,000 for failure to submit the Annual Attestation, on the Business Day following the due date, repeated every 10 Business Days until the attestation is provided to FICC; (2) $15,000 for failure to submit the triennial report, on the Business Day following the due date, repeated every 10 Business Days until the report is provided to FICC, including in the instance where FICC requires a Netting Member to re-perform the review and re-submit the report; and (3) $20,000 for a trade submission failure that FICC has, in its sole discretion, determined not to be appropriately remediated, repeated every 30 Business Days until FICC determines that the failure has been remediated. FICC will report a Netting Member to the SEC unless it cures an issue of noncompliance within 10 Business Days. *See id*. at 148-150 (Fine Schedules).

compliance, without the imposition of penalties. Or, at a minimum, FICC should provide a longer grace period once a Netting Member notifies FICC of non-compliance to perform a thorough review and prepare a report that meets both the Netting Member's and FICC's standards.

IX. ISDA Is Concerned About the Potential Extraterritoriality Impact of the Trade Submission Requirement for Netting Members Generally and Specifically for Inter-Affiliate Trades and Banks.

ISDA is concerned that the Proposal introduces serious cross-border implications that have not yet been fully considered and analyzed. Cross-border issues can arise under the FICC Rules any time a Netting Member trades with a non-U.S. counterparty. The Proposal, though, exacerbates cross-border concerns by providing that "a bank and its branches must all apply under the same membership, as one Bank Netting Member" and that "a branch and its parent bank are considered the same legal entity under the [FICC] Rules and not separate affiliates."[46] This means that all branches of a Bank are considered a Netting Member, even if the Bank's branch is outside the U.S. and enters into repo trades with non-U.S. counterparties with no U.S. nexus.

Additional time is needed to evaluate how the FICC Rules and the clearing mandate should work on a cross-border basis, and, therefore, the Commission and FICC should consider exempting non-U.S. transactions entered into by Netting Members. Many counterparties located overseas are not familiar with FICC and, as such, the onboarding process will prove time-consuming in such instances. Operational issues across time zones could also arise. Further, requiring all outward-facing repo trades of Netting Members, regardless of size and jurisdiction, to be cleared is too onerous a standard. Legal and regulatory concerns also abound: the clearing mandate applies even if non-U.S. counterparties are located in jurisdictions without a favorable close-out netting regime; the relevant non-U.S. jurisdiction might impose regulatory requirements or oversight over any clearing at FICC; or the non-U.S. jurisdiction is not even approved by FICC.[47] Because of these issues, Netting Members could effectively be cut off from entering into U.S. Treasury security repo trades with counterparties that are not otherwise exempted in these jurisdictions, with implications for the Treasury market. Further, Netting Members may end up being at an unfair competitive disadvantage as compared to non-Netting Members who can freely enter into repo trades with non-U.S. counterparties without having to clear them. Until these issues can be worked out, ISDA respectfully requests that the SEC and FICC provide relief from compliance with the trade submission requirement for non-U.S. transactions.

At a minimum, non-U.S. Affiliated Counterparties of Netting Members need to be able to use the inter-affiliate exemption in proposed FICC Rule 5(b)(iv)[48] without having to clear all outward-facing repo trades with non-U.S. counterparties, for the same reasons as noted above. It will be

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[46] *See* Proposal, *supra* n. 3 at 54,605.

[47] *See* FIXED INCOME CLEARING CORP., *Jurisdictions Approved by FICC for Sponsored Members* (Effective Date: Jul. 17, 2024, Last Visited: Jul. 21, 2024), https://www.dtcc.com/-/media/Files/Downloads/Clearing-Services/Approved-FICC-Jurisdictions-for-Sponsored-Members.pdf (listing jurisdictions approved by FICC for Sponsored Members, which, notably, does not include a single jurisdiction in Latin America or Africa).

[48] *See* FIXED INCOME CLEARING CORP., *supra* n. 4, at 128 (Rule 5, Section 1(a)-(b)) which mirrors the definition of ESMT in the Treasury Clearing Rules, *see* 17 C.F.R. § 240.17ad-22(a).

practically difficult if not impossible to clear all repo trades with non-U.S. counterparties, rendering the inter-affiliate relief all but worthless. ISDA asks FICC to join it in working with the Commission on necessary changes.

As an alternative, also requiring parallel Commission action, the definition of ESMT could be revised to be more accommodating to the realities of the market. For example, Netting Members may encounter issues when facing a non-U.S. counterparty located in a jurisdiction for which there is no netting opinion or which FICC has not found to be an approved jurisdiction. Counterparties in these jurisdictions would be constrained from accessing the U.S. Treasury securities market because Netting Members or their affiliates may be unable or unwilling to trade with them. ISDA urges the Commission and FICC to exclude from the definition of ESMT transactions with counterparties in jurisdictions where more work is needed before FICC and Netting Members can achieve trade submission compliance.

As is evident from this discussion, some form of relief is necessary for non-U.S. transactions. ISDA is concerned that without such relief, the Proposal could have a deleterious impact on the proper functioning and liquidity of the Treasury market world-wide.

Conclusion

We appreciate the opportunity to submit comments in response to the Proposal. ISDA members are strongly committed to maintaining the safety and efficiency of the U.S. financial markets and ensuring the efficiency of robust and functional derivatives markets. ISDA supports FICC's efforts to create a trade submission framework to fulfill the Treasury Clearing Rules' mandate for the clearing of certain cash and all repo secondary market trades in U.S. Treasury securities, and hopes that FICC and the Commission will consider our comments, as they reflect the extensive knowledge and experience of financial market professionals within our membership.

We look forward to further engagement with FICC and the Commission on these important issues. Please do not hesitate to contact Chris Young, Head of U.S. Public Policy (cyoung@isda.org), Ann Battle, Senior Counsel (abattle@isda.org), or Nikki Cone, Associate General Counsel (ncone@isda.org) should you have any questions.

Sincerely,

Katherine Darras
General Counsel
International Swaps and Derivatives Association (ISDA)