March 10, 2025

Submitted Electronically

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

Re: ***SEC "Notice of Filing of an Application for Registration as a Clearing Agency Under Section 17A of the Securities Exchange Act of 1934" [Release No. 34-102200; File No. 600-44]***

Dear Ms. Countryman:

The Futures Industry Association ("**FIA**")[1] welcomes the opportunity to submit this letter in response to the U.S. Securities and Exchange Commission's (the "**SEC**" or the "**Commission**") request for comment on the above referenced application (the "**Application**") from CME Securities Clearing, Inc. ("**CMESC**")[2] and in particular CMESC's proposed rules and procedures thereunder ("**Proposed Rules**").[3] As a leading advocate for the cleared derivatives industry, FIA represents market participants who rely on robust, transparent, and efficient clearing systems. FIA supports the expansion of clearing services for U.S. Treasury transactions and has reviewed the Proposed Rules through the lens of its members, who are interested in potentially providing clearing services or otherwise participating as registered Futures Commission Merchant ("**FCM**") members of CMESC. While we recognize the potential benefits of CMESC's initiative, including the increased diversity in access model, we believe that certain key aspects of the Proposed Rules require further refinement to ensure they will allow FCMs to participate, thereby supporting the transition to clearing and promoting market integrity, financial stability, and broad participation.[4]

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[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, D.C. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the U.S. Commodity Futures Trading Commission as futures commission merchants, the majority of which are also registered with the SEC as broker-dealers.

[2] Notice of Filing of an Application for Registration as a Clearing Agency under Section 17A of the Securities Exchange Act of 1934 (Jan. 15, 2025), available here.

[3] Terms used but not defined herein shall have the meaning given to such terms in the Proposed Rules.

[4] FIA has been active in commenting on various proposals related to Treasury Clearing and recognizes the important role of the U.S. Treasury market in the global financial system. See Futures Industry Association, Comment Letter on Standard for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With

FCMs handle more than 90 percent of the customer funds held for trading on U.S. futures exchanges and are the source of the majority of the assets providing liquidity for the clearing organizations of such exchanges. In providing clearing services for customer funds, FCMs commit a substantial amount of their own capital to guarantee customer transactions. As such, FIA members (being FCMs) generally have significant expertise with the capital and regulatory capital impact of providing customer clearing in futures, options and swaps. Based upon this expertise, FIA has identified a number of areas in which the Proposed Rules should be enhanced, particularly with respect to regulatory capital treatment and risk management considerations. As currently proposed, the substantial capital required for FIA members to offer clearing to their customers pursuant to the Proposed Rules may have a significant adverse impact on their capacity to offer clearing through CMESC. This would frustrate the objective of incentivizing and facilitating additional central clearing in the U.S Treasury market which the requirement that market participants submit eligible secondary market transactions in U.S. Treasury securities for clearing and settlement (the "**transaction submission requirement**") under was intended to achieve.

FIA appreciates the innovation in CMESC's access model, by narrowing the role of clearing members, but we feel strongly that the Proposed Rules must not be approved until the regulatory capital impact of this untested approach is fully understood and confirmed by CMESC's Members. More specifically, the novel approach to the default management process proposed by CMESC does not yet appear well-suited to allowing Members to recognize exposure to their User customers on a net basis. While the Proposed Rules would calculate a Member's obligations under the guarantee in respect of a User it authorizes on a net basis, FIA does not believe that the Proposed Rules would meet the conditions that would allow members to hold capital against that exposure on a net basis. Under the U.S. implementation of the capital rules under the Basel Framework[5] (the "**capital rules**"), a banking organization is only permitted to recognize the effects of financial collateral or offsetting transactions for capital purposes if the banking organization satisfies certain requirements. These requirements include that the banking organization must have the right to terminate the transaction and set off or apply collateral "promptly upon an event of default" under the bilateral agreement between the banking organization and its customer. If a clearing member is unable to meet these requirements, it must hold capital without regard to such collateral or offsetting transactions, *i.e.*, against its "gross exposure" to the customer. The significant costs associated with "gross exposure" capital calculations are such that they typically render it prohibitively expensive to offer clearing services to customers.[6]

We also urge the Commission and CMESC to consider in particular the challenges presented by the Proposed Rules for FCMs to continue participating in repurchase transactions in compliance with Rule 1.25 of the Commodity Futures Trading Commission ("**CFTC**"). As FIA has previously detailed in comment letters to the Commission, revisions to CFTC Rule 1.25 will be required to fully realize the migration to clearing of those transactions. Pending such needed updates, FIA urges CMESC to amend the Proposed Rules to include an exemption from the transaction submission requirement for transactions that would

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Respect to U.S. Treasury Securities (December 23, 2022, available here); Futures Industry Association, Principal Traders Group, Comment Letter on FICC Rule Proposals to Facilitate Access to Clearance and Settlement Services and to Segregate Client Margin (April 17, 2024, available here); Futures Industry Association, Comment Letter on SEC "Notice of Filing of Proposed Rule Change, as Modified by Partial Amendment No. 1, To Modify the GSD Rules To Facilitate Access to Clearance and Settlement Services of All Eligible Secondary Market Transactions in U.S. Treasury Securities" (April 18, 2024, available here); Futures Industry Association, Principal Traders Group, Comment Letter on Notice of Filing of a Proposed Rule Change to Modify the GSD Rules Relating to the Adoption of a Trade Submission Requirement (SR-FICC-2024-009) (July 23, 2024, available here); Futures Industry, Comment Letter on SEC "Notice of Filing of Proposed Rule Change To Modify the GSD Rules Relating to the Adoption of a Trade Submission Requirement" (August 6, 2024, available here); Futures Industry Association, Principal Traders Group, Comment Letter on SR-FICC-2024-005, SR-FICC-2024-006, SR-FICC-2024-007, SR-FICC-2024-009 (Access, Margin & Trade Submission) (October 11, 2024, available here).

[5] The Basel Framework is a consolidated version of the full set of 14 standards published by the Basel Committee on Banking Supervision.

[6] Such costs could impair the ability of CMESC to "provide means to facilitate access to clearance and settlement services of all eligible secondary market transactions in U.S. Treasury securities." SEC Rule 17ad–22(e)(18)(iv)(C).

violate applicable law, including the Commodity Exchange Act ("**CEA**") and CFTC requirements thereunder, if cleared pursuant to the Proposed Rules.

EXECUTIVE SUMMARY

The standards for clearing agencies published in SEC Rule 17ad-22 includes a standard requiring covered clearing agencies to establish written policies and procedures that ensure 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; FIA is concerned that the Proposed Rules currently fall short of this requirement. Specifically, FIA's concerns include:

- Ensuring appropriate bank regulatory capital: CMESC should (a) provide the ability for a Member to trigger a default with respect to its User's transactions at such Member's election; (b) provide a mechanism to liquidate the User's transactions, considering implications under all relevant jurisdictions; (c) limit the scope of liability for Members upon voluntary withdrawal; (d) require CMESC to grant withdrawal requests for excess margin unless the relevant Participant is in Default; and (e) revisit the liquidity and default management resources required of Members, including without limitation unsecured loans, capped liquidity facilities, uncapped offsetting transactions, as well as restrictions on Member withdrawals to ensure they are appropriately calibrated, articulated and defined to avoid unnecessary risk and costs to Members and that the liability can be measured and assessed by Members.

- Risk management and default management: CMESC should (a) provide Members with more control and transparency over actions that impact their risk management; (b) not be able to force a buy-in following a failed settlement of a cleared transaction and such decision should instead be left to the Participant to which the fail charges are allocated; and (c) clarify that porting of transactions outside of a default scenario requires the consent of the transferee Member, the transferor Member and the User, and that, in a default scenario, CMESC would need to consider the rights and obligations of any applicable insolvency practitioner of the transferor Member.

- Direct relationship between Users and CMESC: CMESC should (a) allow authorizing Members to direct CMESC to deliver settlement payments or return margin to such Member in the event of a User default; and (b) agree to act as a securities intermediary with respect to a User's margin and to act on the instructions of an authorizing Member (e.g., through an account control agreement) so that an authorizing Member can perfect a security interest in margin posted to CMESC by a User.

- Enhance risk management of Members: CMESC should (a) raise the minimum capital requirement for Members; and (b) raise CMESC's own contribution to the default waterfall to a size determined dynamically.

- Calibrate Member responsibility for Users: CMESC should (a) not require an authorizing Member to undertake specified due diligence on its Users beyond the Members' own risk management as CMESC has the primary relationship with such Users; (b) clarify that authorizing Members are not responsible for any liability of any User to CMESC due to any disciplinary action against the User; and (c) take the most appropriate action to manage transactions of the Users of a Defaulting Member, in order to efficiently resolve the default while minimizing the impact on other Participants.

- The SEC's transaction submission requirement: CMESC should (a) allow all entities who are party to transactions within the scope of the transaction submission requirement to become Users; (b) consider the implications of adding new products to those eligible to be cleared at CMESC;

(c) clarify that certain transactions that have been submitted for clearing but are rejected transactions may continue bilaterally; (e) allow banks to obtain membership through a branch without subjecting the entire bank to the transaction submission requirement; and (e) future-proof the implementation of the transaction submission requirement by explicitly incorporating any SEC interpretations or guidance relating to the transaction submission requirement.

- Cross margining: CMESC should confirm that the Independent and Supported User models are compatible with future potential cross-margining solutions between CMESC and CME.

- Address concerns from the application of CFTC Regulation 1.25:[7] CMESC should (a) adopt an applicable law exception from the transaction submission requirement; and (b) enhance the Proposed Rules to accommodate compliance with applicable CFTC requirements.

- Legal Opinions: CMESC should obtain, and make available to Participants on a reliance basis, legal opinions regarding (a) the treatment of Outstanding Exposure Settlement ("**OES**") as settlement; (b) margin being held in a "bankruptcy remote" manner; and (c) enforceability of the Proposed Rules against Members and Users.

Each of these concerns is discussed in detail below, along with recommended modifications to the Proposed Rules to ensure they align with regulatory requirements while promoting market efficiency and liquidity.

DISCUSSION

I. CMESC's Proposed Rules in relation to default management, and liquidity and margin processes present significant risk management and capital concerns.

a. The Proposed Rules should expand and clarify the ability for a Member to trigger a close-out by CMESC upon default of its User, consistent with the FCM clearing model.

Successful clearing of U.S. Treasury securities will require significant market clearing capacity and FIA is concerned that Members will not be able to achieve a net exposure to User customers for capital purposes based upon the Proposed Rules. Specifically, the Proposed Rules do not allow a Member to trigger a close-out of its User's transactions (whether by directing CMESC to effect a close-out or otherwise), without consent of CMESC. Proposed Rule 1507(b) permits a User's authorizing Member to close out the User's transaction by satisfying any obligations owed to CMESC, but only where the User is a "Defaulting User," which is defined as a User treated by CMESC as insolvent, or with respect to which CMESC has ceased to act. As a result, an authorizing Member does not have an independent ability to trigger a close out of the User's transactions in all circumstances where the User may be in default to the Member under the agreement governing their clearing relationship. For example, if an authorizing Member has satisfied CMESC's margin call in respect of a Supported User, but the Supported User fails to satisfy the corresponding margin call received from that Member, the Member would have no right under the Proposed Rules to trigger a default of the User and close out the User's positions without CMESC's consent to treat the User as a Defaulting User.

This is a critical problem for Members, as the inability to close out User transactions may require a Member to continue treating a defaulting User's transactions as outstanding and may prevent a Member

[7] 17 C.F.R. § 1.25. As described more fully in Section VIII below, CFTC Regulation 1.25 allows FCMs to invest customer funds with the objectives of preserving principal and maintaining liquidity. Thus, FCMs are limited in making investments using customer funds to specified instruments, including U.S. Treasury securities, U.S. agency obligations, interests in money market mutual funds, municipal securities, and certificates of deposit. 17 C.F.R. § 1.25(a)(1).

from determining that it can net the cleared transactions for purposes of the capital rules, thereby requiring a Member to hold capital against gross exposures. The Proposed Rules may give rise to highly punitive costs and undermine both the regulatory capital treatment and risk management of the Member's clearing operations. Generally, for purposes of capital calculations under the capital rules, the exposure of a clearing member to its client where such clearing member provides a guarantee to a central counterparty on the performance of the client is generally determined, with respect to repurchase agreements, through the lens of a "repo-style transaction" analysis which, among other things, requires that the transaction be "executed under an agreement that provides the [institution] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default."[8] We understand that CMESC's retention of discretion over the close-out process was intended to complement the direct clearing relationship between CMESC and its Users, and that there may be hesitation by CMESC to upset the balance of the CMESC-Member-User relationships. However, the ability of an authorizing Member to participate in the close-out process won't override the User's control, as Members and their Users will have agreed, in their clearing documentation, the circumstances in which the Member is permitted to take action in respect of a close-out. Taking this into consideration, an adaptation to the CMESC rules to permit Members to initiate a close-out, including by CMESC, will still be compatible with the direct CMESC-User relationship and will not fundamentally change the way in which CMESC deals with Users (or their Members).[9]

In order to allow CMESC to fulfill its obligation under SEC Rule 17ad-22(e)(21) to be efficient and effective in meeting the requirements of its participants, and SEC Rule 17ad-22(e)(23)(i) to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures, thereby fully supporting the development of U.S. Treasury securities clearing, FIA strongly urges CMESC to work with the industry to amend the Proposed Rules to include (i) the ability for a Member to trigger a default with respect to its User's transactions at such Member's election, and (ii) a mechanism to liquidate the User's transactions, considering implications under all relevant jurisdictions. Such a mechanism should, at a minimum, include the ability to direct CMESC to transfer a defaulting User's transactions to the Member's proprietary account to achieve results consistent with the rights of FCMs under the rules of the clearing services offered by derivatives clearing organizations (each a "**DCO**").

Additionally, the interaction between Proposed Rule 413 and Proposed Rule 903 raises serious questions regarding the potential residual liability of a Member following a voluntary withdrawal as a Member of CMESC. FIA is concerned that such resigning Member's potential obligation to CMESC in respect of the Guaranty Fund could extend over a period of unknown duration, including past the expiration of the 10-day notice of withdrawal. Under Proposed Rule 903(a), a Member may voluntarily withdraw from membership by providing 10 business days' notice to CMESC. However, Proposed Rules 903(b) and (c) specify that amounts due by the Member before the resignation in respect of contribution to the Guaranty Fund or in respect of Default Assessment continue to be payable, and further amounts of Guaranty Fund contribution or Default Assessment can continue to be claimed from the Member (up to its specified maximum amount) during and after the notice period, until the withdrawal becomes effective. Proposed Rule 413 provides that both Default Fund contributions and Default Assessment amounts remain payable during the "cooling off period"[10] following a Member default, which period can extend in 5 business day-increments indefinitely, for so long as additional Member defaults occur during the period. When read together with Proposed Rule 903(a), the withdrawal of the Member under 903(a) will be effective only once

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[8] 12 C.F.R. § 217.2 (Cleared transaction), n. 3; 12 C.F.R. § 217.2 (Repo-style transaction).

[9] As discussed in Section VII below, we expect this issue would also present an impediment to potential cross-margining solutions between CMESC and CME.

[10] Non-Defaulting Members are subject to Guaranty Fund contributions during the cooling off period, defined as the period from the date of an original Default until the ***later of*** (i) the fifth Business Day thereafter or (ii) if another Member Defaults during the five (5) Business Days following the initial or any subsequent Default, the fifth Business Day following the last such Default, regardless of the number of Defaults that occur during such Cooling Off Period. See Proposed Rule 413.

the cooling off period (however long it continues) expires. Accordingly, the potential liability of a Member seeking to resign may continue beyond the 10 business days' notice and is limited only by the (unascertainable) duration of the cooling off period and the Member's specified maximum amount for obligations in respect of the Guaranty Fund. This scenario could constitute a serious level of risk for Members, and therefore we would encourage CMESC to revise Rule 413(b) to specify that the liability of a withdrawing Member who is not in default should not continue beyond the later of (i) the date on which the 10-business day notice under Rule 903(a) expires and (ii) the end of the initial 5-business day cooling-off period following a Member default (i.e., the cooling off period is effectively limited to 5 business days). We would note that this change would materially reduce Members' uncertainty around their potential risk, and would thereby demonstrate CMESC's compliance with the requirement in SEC Rule 17ad-22(e)(23)(ii) to provide sufficient information to enable Participants to identify and evaluate the risks, fees, and other material costs they incur by participating in CMESC's clearing services. This revision would prevent a Member from being exposed to potentially significant exposure over an indefinite duration.

As a separate point, Proposed Rule 1507(b) provides that, in the case of a defaulting User, if time permits, CMESC will "notify the authorizing Member(s) of the Defaulting User that the Member(s) may terminate the Defaulting User's obligations to [CMESC] by satisfying them in full." Although this may be a helpful option to be available for Members, it is not clear what it means for a Member to "terminate the Defaulting User's obligations to [CMESC] by satisfying them in full," and therefore CMESC should amend the Proposed Rules to clarify how this is intended to work.

b. CMESC should limit its discretion to deny requests by Members and Users to withdraw excess margin.

Where the amount of posted margin exceeds the required amount, a Member or User is ordinarily permitted to withdraw the excess.[11] However, under the Proposed Rules CMESC retains a discretionary right not to allow such a withdrawal if CMESC determines it is necessary for the protection of itself, the Members, the Users or the general public. This discretion to refuse withdrawals is a concern for FIA members and likely their User customers and, in particular the broad scope of discretion that extends to the protection of the public, which is a risk that could be difficult to identify, let alone predict.[12] The Proposed Rules should be amended to require CMESC to grant withdrawal requests for excess margin unless the relevant Participant is in Default.

c. CMESC should clarify the scope of Capped Liquidity Facility ("CLF") amounts and review whether the effective exposure of Members through CLF and other liquidity management tools is greater than needed and should be reduced.

In order to adequately address and manage potential risk and exposure associated with participation on CMESC, it is critical to understand how exposures under the CLF are calculated. FIA is concerned that the lack of clarity regarding CLF calculations raises the potential for CLF contributions to be prohibitively large, with CMESC retaining broad discretion over the timing, necessity and allocation of such contributions.[13] Consistent with CMESC's obligations under SEC Rule 17ad-22(e)(23)(ii) to provide market participants with sufficient information to identify and evaluate the risks and costs associated with using CMESC's services, Proposed Rule 410 should be revised to include more detail about the specific

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11 See paragraph (a) of Proposed Rule 510

12 See also in particular with respect to customer collateral below in Section VIII.b.i.

13 See Proposed Rule 410.

process for determining the maximum amount of the CLF Event Transaction for each Member, and the order of selection of Members with which CMESC will enter into CLF Event Transactions.[14]

Proposed Rule 1509 permits CMESC pursuant to its default management process to enter into offsetting transactions with non-defaulting Participants, which have the effect of extending the settlement obligations of such transactions by one business day. CMESC is permitted to do this for a maximum of two sequential business days. This potential lack of settlement certainty in CMESC's clearing services is a serious concern for both Members and Users. Settlement certainty is critically important as reflected in the inclusion of a requirement for settlement finality in Principle 8 of the Committee on Payments and Market Infrastructures ("**CPMI**") and the International Organization of Securities Commissions ("**IOSCO**") "Principles for financial market infrastructures" (the "**PFMIs**") published by the Bank for International Settlements (the "**BIS**").[15] In fact, when discussing settlement finality in the PFMIs, the BIS and the IOSCO note that "deferring final settlement to the next-business day can create both credit and liquidity pressures for [the participants of a provider of financial market infrastructure] and other stakeholders, and potentially be a source of systemic risk." It should be emphasized that CMESC already has the power under the CLF to effectively postpone settlement by entering into CLF Event Transactions with selected non-defaulting Members. While these CLF Event Transactions may serve to effectively defer settlement, the total possible liability under such transactions is limited to the size of the relevant Member's respective CLF pre-specified maximum amount, rather than the uncapped liability that would result from extending settlement outside the CLF context.[16]

CMESC does not need the additional power to defer settlement through offsetting transactions, nor is it appropriate without any cap on the size of the possible deferred settlement amount. The uncertain degree of credit and liquidity pressure, as identified by IOSCO/BIS in the PFMIs, could expose Members to an unmanageable level of risk. This mechanism should be removed from the CMESC Proposed Rules. If CMESC does not remove this mechanism from the Proposed Rules, the imposition of offsetting trades under this mechanism should be subject to the same limit as the CLF, applied as a single, shared limit across both features.

II. <u>Risk management provisions in the Proposed Rules must be amended to reduce risks and capital consequences to Members.</u>

a. Members should be provided with more control and transparency over actions that impact Member risk management.

Pursuant to Proposed Rule 1503(d), the two original parties to a repurchase transaction that has been submitted for clearing may mutually agree to modify or cancel the transaction after submission and novation to CMESC. Where such a modification or cancellation is agreed in respect of a done-away transaction between a User and its executing counterparty, the cancellation/modification of the transaction could take effect by notice to CMESC but without notice to the Member of the User. This could be problematic where the Member is not comfortable with the modified terms of the transaction (particularly if the amendment affects any previously completed limit checks), or the cancellation increases the Member's risk under another of its transactions. Therefore, CMESC should amend the Proposed Rules to require consent from the relevant Member with respect to any such cancellation or modification.

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[14] Consistent with the discussion in Section I above, CMESC should similarly ensure that capital treatment for offsetting transactions are regarded as cleared transactions for purposes of regulatory capital treatment.

[15] and the International Organization of Securities Commissions (the "**IOSCO**")

[16] See also 17 CFR 240.17ad-22(e)(8) (requiring clearing agencies to define the point at which settlement is final to be no later than the end of the day on which the payment or obligation is due).

b. CMESC should not be able to force a buy-in following a failed settlement of a cleared transaction and such decision should instead be left to the Participant to which the fail charges are allocated.

Upon a failure by a Participant to deliver securities to settle a cleared transaction, we understand that CMESC may elect to buy-in the failed Participant, effectively crystallizing the loss or gain at that point. Market practice is to charge fails charges to a Participant that has failed to timely deliver such securities. While we support CMESC's option for a Participant to submit a buy-in request to CMESC, CMESC should abide by market practice and charge fails charges where a Participant has failed to timely deliver such securities, and leave it to the Participant to determine whether to continue to receive fails charges or submit a buy-in request to CMESC.

c. CMESC should clarify that porting of transactions outside of a default scenario requires the consent of the transferee Member, the transferor Member and the User, and that, in a default scenario, CMESC would need to consider the rights and obligations of any applicable insolvency practitioner of the transferor Member.

Pre-default porting, when none of the relevant parties is in default under the Proposed Rules, is a feature that allows a User to transfer one or more (or all) of its transactions from one authorizing Member of that User to another Member who is already, or will commence, authorizing that User. A porting User does not require a specific reason for electing to port its transactions, and such porting could, for example, result from a perceived risk of imminent insolvency of the relevant authorizing Member or a desire to develop the strength of its clearing arrangements with another Member. FIA welcomes the inclusion of porting features in the Proposed Rules. However, the language providing for pre-default porting under the Proposed Rules is unclear and could be read to suggest that a transaction may be ported at the request of either the User or the transferor Member, but the Proposed Rule is not clear that all parties, including the transferee Member, must consent to such a transfer. This language in the Proposed Rule should be revised to explicitly require, in respect of the porting of a relevant transaction, the consent of the User, the transferor Member and the transferee Member for that transaction.

III. CMESC should make changes to the Proposed Rules to address certain challenges that arise as the result of the direct access model.

FIA supports CMESC's proposal to allow for the direct settlement of transactions between CMESC and Users under the Supported User model, as well as to allow Independent Users to post margin and make OES transfers directly to CMESC. However, as currently structured, certain aspects of the Proposed Rules make both the Independent User model and the Supported User model challenging for Members and may expose Members to unnecessary liability and risk.

a. Upon a User Default, a Member should be able to notify CMESC and direct CMESC to deliver settlement payments to the Member or return margin to the Member with respect to transactions cleared through such Member.

Without the ability to receive payment flows from CMESC upon a User Default, even with a perfected security interest in such amount, the Member would not have a practical means of foreclosing on such margin or payment. This could have negative implications for members relying on such collateral for capital purposes or relying on a security interest in the cleared transactions to net between cleared transactions and bilateral repurchase transactions or other products. The Proposed Rules, therefore, should be amended to provide that upon a User Default, CMESC will act only on instruction of the Member in relation to the cleared transactions proceeds or margin and will make deliveries and payments in respect thereof only to the authorizing Member.

b. CMESC should agree to act as a securities intermediary with respect to a User's margin and to act on the instructions of an authorizing Member (e.g., through an account control agreement) so that an authorizing Member can perfect a security interest in margin posted to CMESC by a User.

Under the Independent User model, because the Independent User would transfer margin and OES directly to CMESC without intermediation by its authorizing Member,[17] an authorizing Member would be required to perfect its security interest in margin posted to CMESC through UCC financing statements, which are a more time-, cost-, and risk-intensive means of perfection than control, given the risk of an intervening lien. This issue does not arise in other clearing models (including under CMESC's Supported User model) where all margin flows through a clearing member to the clearing agency, which allows the clearing member to perfect its security interest in the margin by control rather than by filing UCC financing statements. CMESC's proposal, however, envisions Independent Users providing margin directly to CMESC without the margin ever flowing through the Member.

Rather than requiring a Member to file a UCC financing statement, CMESC should agree to act as a securities intermediary with respect to such margin and to act on the instructions of an authorizing Member (for example, to enter into account control agreements with authorizing Members) which would allow an authorizing Member to perfect its security interest in User margin by control. So long as the terms of the agreement allow the Member to perfect its security interest in the margin posted by a User and provide the Member with the requisite access to the subject collateral, the agreement could be entered into pursuant to a non-negotiable agreement form entered into as part of the Member's onboarding process with CMESC, and would not need to be individually negotiated with each Member. We would therefore not expect that undertaking such agreements would impose any significant additional operational burden or cost on CMESC.

IV. CMESC should enhance its risk management of Members by increasing minimum capital and guarantee fund contribution and ensuring enforceability of rules against Members and Users.

a. The minimum capital requirement for CMESC Members should be higher than proposed to ensure that no Member poses an unreasonably high risk to the other Members.

Proposed Rule 306(b), which sets out the minimum financial responsibility standards for members, requires that any Member applicant that is (i) a broker-dealer must have at least $20 million in net capital,[18] (ii) a bank must have at least $500 million in common equity tier 1 ("CET1") capital,[19] (iii) a non-broker-dealer FCM must have at least $20 million in adjusted net capital,[20] (iv) an unregistered investment pool must have at least $150 million in net assets,[21] and (v) any other category of persons must have a minimum capital amount as set by CMESC.

While Proposed Rule 306(b)(vi) gives CMESC discretion to impose higher capital and liquidity requirements on Member applicants, we believe that the default capital requirements should generally be higher and should be adjusted based on the activity of the Member applicant. Additionally, where a Member applicant plans to authorize one more Users, in order to avoid exposing other Participants to unnecessary risk of default, we believe the minimum capital requirements for such Member applicant should be higher

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17 See Proposed Rule 501.

18 For this purpose, "net capital" is defined in SEC Rule 15c3-1.

19 For this purpose, CET1 capital is defined by the bank's primary regulator. If the bank is a non-U.S. bank, the rule provides that the foreign regulatory equivalent of the CET1 measure should be used.

20 For this purpose, "adjusted net capital" is defined in CFTC Regulation 1.17.

21 For this purpose "net assets" is equal to total assets minus total liabilities.

than the requirements for a Member that is solely engaged in clearing its own transactions. We believe higher thresholds should apply notwithstanding that certain Members may satisfy regulatory minimum capital requirements. For example, a broker-dealer or a non-broker-dealer FCM may otherwise only have a minimum capital requirement of only $20 million.[22] Establishment of higher thresholds is consistent with CMESC's obligation under SEC Rule 17ad-22(e)(18)(ii) to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in CMESC.

b. CMESC's contribution to the default waterfall should be raised from $50 million, and the size should be determined dynamically.

Proposed Rule 406(a) provides that, in the event of a Member Default, and if the margin posted to CMESC in respect of open transactions in the Defaulting Member's account does not fully cover the losses, CMESC shall contribute up to $50 million towards discharging the loss.

Given the size of the U.S. Treasury market and expected activity of CMESC, and in order to ensure compliance with SEC Rule 17ad-22(e)(4) (requiring a covered clearing agency to maintain financial resources to enable it to cover a wide range of foreseeable stress scenarios), CMESC should increase its corporate contribution to be more in line with the level of contribution provided by other clearing agencies authorized to clear U.S. Treasury securities[23] and by CME in relation to the clearing services offered for its various products.[24] Preferably, CMESC should use a dynamic model to calculate the amount of its required contribution at any given time, rather than specifying a fixed amount for the contribution. The dynamic model could incorporate a variety of factors (e.g., ten percent of the total Guarantee Fund subject to a floor), and this would allow CMESC's contribution to adjust with the growth in the level of participation in CMESC's clearing service over time. If CMESC is not comfortable selecting a dynamic model itself (for example, based on models that may be used by other clearing services), CMESC could commission a study, including representation from the SEC and industry practitioners, with the purpose of identifying an appropriate risk-based methodology to recommend to CMESC for calculating and structuring its contribution amount, taking into account the structure and internal organization of CMESC and the nature, scope, complexity, and risk of its activities.

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22 Proposed Rules 306(b)(i),(iii).

23 Section 7a of FICC's GSD Rule 4 provides that FICC's corporate contribution (which is available to both the Government Securities Division and the Mortgage-Backed Securities Division) is inherently dynamic and generally equal to 50% of FICC's general business risk capital requirement under Rule 17Ad-22(e)(15) of the Exchange Act. FICC may also voluntarily allocate an amount greater than 50 percent of its general business risk capital requirement to address an unsatisfied loss or liability if FICC believes it to be prudent due to existing circumstances. As of December 31, 2024, FICC maintains its corporate contribution at over $105 million. *See* FICC, Financial Statements as of and for the Years Ended December 31, 2024 and 2023, and Report of Independent Registered Public Accounting Firm, p.19, available here. The Options Clearing Corporation ("OCC") maintains a Minimum Corporate Contribution as the minimum level of OCC's own funds exclusively to cover credit losses or liquidity shortfalls, the level of which the OCC's board of directors shall determine from time to time. For 2024, OCC's board approved a Minimum Corporate Contribution of $61 million. *See* Exchange Act Release No. 34-99951 (April 12, 2024), 89 FR 27818 (April 18, 2024).

24 Section 802B of Chapter 8 of the CME Rules provides that the contribution of CME in relation to its cleared transactions, other than IRS Contracts (as defined in the CME Rules), will be $100 million, while Section 8G802.B of Chapter 8G of the CME Rules provides that the contribution of CME in relation to IRS Contracts will be $150 million.
"CME Rules" means the certificate of incorporation, by-laws, rules, interpretations, orders, resolutions, advisories, notices, manuals and similar directives of the Chicago Mercantile Exchange Inc., and all amendments thereto.

V. Members' responsibility for Users should be calibrated to reflect the direct relationship between CMESC and Users.

a. An authorizing Member should not be required to undertake due diligence on its Users beyond the level it deems necessary for its own risk management purposes.

Proposed Rule 306(c) provides that Members must have and maintain written operational procedures covering due diligence and monitoring of Users it authorizes, but the scope of this risk monitoring is not clear. It is uncertain from the Proposed Rules whether a Member needs to monitor only the risks relating to a User's clearing activities at CMESC, or the risks arising from all aspects of the User's business activities that may affect the User's clearing activities at CMESC or its ability to perform its obligations under CMESC-cleared transactions.

While Members should be expected to conduct reasonable due diligence related to new Users and would do so in compliance with their own prudential requirements and standards in light of the guarantee of User's obligations which they are providing, the requirements should be narrowed such that Members would only be required by the rules of CMESC to report certain, specified events to CMESC that they become aware of during in the ordinary course of their business, rather than be subject to the more general risk monitoring requirements under the Proposed Rules. Given CMESC's direct relationship with Users, CMESC should have primary responsibility for managing the risk associated with Users. Alternatively, and at a minimum, the Proposed Rules should (i) clarify that the monitoring requirement applies only with respect to the User's clearing activities at CMESC through the relevant Member, and (ii) require Users to comply with any requests from their authorizing Members for due diligence and risk monitoring purposes.

b. Members should not be liable for any breaches of the Rules by Users, or any penalty amounts owed by Users to CMESC.

Unlike in most clearing models, where the clearing member has primary responsibility for performance under the cleared transaction, Users would have a direct relationship with CMESC under the Proposed Rules, and CMESC would have authority to discipline Users for violations.[25]

CMESC should amend the Proposed Rules to make clear that Members would not be liable for any breaches of the Proposed Rules by Users the Member has authorized, or for any amounts owed by Users the Member has authorized to CMESC as a result of disciplinary actions against the User under the Rules.

c. CMESC should take the most appropriate action to manage transactions of the Users of a Defaulting Member, in order to efficiently resolve the default while minimizing the impact on other Participants.

When handling a Member default, where that Member authorizes one or more Users, Proposed Rule 412 provides CMESC the option to liquidate the transactions of such Users or, for any such Users who are not also defaulting, to port the transactions of such Users to other non-defaulting Members. Although liquidation may be the simplest option for CMESC to manage the User transactions, this will bring an early end to the commercial agreements made between those Users and their original counterparties, in a situation where (in most cases) both of them are able to perform and would prefer the transaction to continue. One of the key benefits of central counterparty clearing is the elimination of each

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[25] *See* Proposed Rule 1001(b), providing that CMESC may "discipline any Member or User for a violation of any provision of the Rules or the Procedures of [CMESC], such Member's or User's agreements with [CMESC], or for any error, delay, or other conduct detrimental to [CMESC], or for not providing adequate facilities for such Member's or User's business with [CMESC], by expulsion, suspension, limitation of or restriction on activities, functions, and operations, fine or censure, or any other appropriate sanction."

party's exposure to its counterparty's credit risk through the intermediation of a shared counterparty, with the result that, on the failure by either party to perform, the transaction can continue for its remaining term with respect to the other party. Accordingly, any outcome under Proposed Rule 412 where CMESC liquidates a User's transactions, when this was not the User's preference, should be seen as less than ideal, as it represents an effective failure of the clearing service to de-link the credit risk of each side from the other. A better outcome would be if CMESC's actions on a Member default were taken with the express aim of minimizing losses from the Member default while also keeping liquidation of User transactions to a minimum, for example, by porting each transaction of such a User to another Member who authorizes such User. However, given the fact that many transactions in the Treasury market settle overnight, it may often be more practicable for CMESC to settle such transactions as normal on their scheduled settlement dates (subject to the requirements of the insolvency regime applicable to the defaulting Member) rather than to port them. We would therefore request that Proposed Rule 412 is amended to provide that CMESC should, in respect of each transaction of a non-defaulting User following the Default of its authorizing Member, either allow such transaction to remain outstanding and be settled between CMESC and the User on its scheduled settlement date or port such transaction to another non-defaulting Member, such that this other Member becomes the authorizing Member for the relevant User in respect of that transaction, and only liquidate the transaction if porting and settlement cannot be effected.[26]

VI. CMESC should consider the interaction between the Proposed Rules and the scope of the SEC's transaction submission requirement.

a. The transaction submission requirement should align with the scope of permitted Users and the transaction types cleared by, CMESC.

Where a Member enters into a transaction in-scope for the transaction submission requirement with a counterparty that is not eligible to be a User, such transaction would be required to be cleared pursuant to the Proposed Rules, but would not be able to be cleared through CMESC, under any of the clearing models that CMESC proposes. This would potentially force a Member to clear such transaction at a different covered clearing agency at which the counterparty may be eligible to become an indirect member.

Paragraph (a) of Proposed Rule 302 provides that specified persons may be approved as either a Member or a User at CMESC, including broker-dealers, banks, FCMs, certain unregistered investment pools, and proprietary trading firms. Paragraph (b) of Proposed Rule 302 provides that, in addition to the persons who can be either Members or Users, the "following persons" may be approved as a User at CMESC, including trust companies, clearing agencies, registered investment companies, and insurance companies. While paragraph (c) of Proposed Rule 302 permits CMESC to allow additional categories of persons to be Members or Users (at CMESC's discretion), Proposed Rule 302 as a whole appears to restrict Users to only certain categories of persons.

Therefore, CMESC should amend Rule 302 to expressly provide that all persons that are counterparties to transactions in-scope of the transaction submission requirement are eligible to become Users.

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[26] *See also* Depository Trust & Clearing Corporation, Comment Letter on Notice of Filing of Proposed Rule Change to Modify the GSD Rules (i) Regarding the Separate Calculation, Collection and Holding of Margin for Proprietary Transactions and That for Indirect Participant Transactions, and (ii) to Address the Conditions of Note H to Rule 15c3-3a ("Margin Segregation Proceeding Order") and to Modify the GSD Rules to Facilitate Access to Clearance and Settlement of All Eligible Secondary Market Transactions in U.S. Treasury Securities ("Access Model Proceeding Order") at 25–26 (available here). In response to comments received, FICC agreed with a commenter that FICC should have the ability to settle outstanding cleared transactions that a Defaulting Member has cleared, explaining that in many instances, settlement may be the most effective and customer-protective way to address a Member default scenario.

CMESC should clarify Proposed Rule 202 that, if a Member enters into an in-scope transaction with an in-scope counterparty who is not eligible to become a Participant at CMESC, either pursuant to the Proposed Rules or because the Participant would not be able to clear such transaction through to CMESC's clearing service in accordance with restrictions under applicable law, such transaction would not constitute an "Eligible Secondary Market Trade" under the Proposed Rules and, therefore, would not be required to be cleared under paragraph (b) of Proposed Rule 202 (at either CMESC or another covered clearing agency), because it is not clearable at CMESC. We note that, in FICC's previously proposed rules implementing the transaction submission requirement, which have since been withdrawn given the extension of time to comply with the transaction submission requirement, Section 1(a) of proposed Rule 5, which is the equivalent provision under FICC's rules to CMESC's Proposed Rule 202, addresses this issue by only requiring the submission of secondary market transactions in U.S. Treasury securities "where the transaction is of a type that is accepted by [FICC]."

b. CMESC should consider the scope and impact of the transaction submission requirement in connection with its eligible cleared product offerings.

FIA is concerned that as new clearing agencies begin to provide clearing services, the scope of the transaction submission requirement could expand unmanageably if new products are made available for clearing too quickly. The transaction submission requirement applies to "Eligible Secondary Market Transactions," being in-scope transactions "of a type accepted for clearing by a registered covered clearing agency."[27] While not entirely clear, the transaction submission requirement could be read to cover submission of any Eligible Secondary Market Transaction that is accepted for clearing by any clearing agency, even potentially where the counterparties to the transaction are not direct or indirect members of such clearing agency. Accordingly, CMESC should ensure that any changes to their cleared offerings are subject to notice and comment well in advance of any proposed launch, pursuant to the SEC Rule 19b-4 process.[28]

CMESC should also clarify the Proposed Rules to avoid undue disruption to the Treasury markets. Currently the Proposed Rules provide that each Member must submit "Eligible Secondary Market Transactions" (defined by cross-referencing the transaction submission requirement in the Exchange Act)[29] to either CMESC or another covered clearing agency for clearing.[30] We understand Treasury transactions eligible to be cleared by CMESC would include, among others, bilateral intraday (T+0),[31] overnight,[32] and term (2 years or less)[33] repos. We understand no other clearing agency offers clearing of intraday repos, meaning that these transactions are currently out of scope for the transaction submission requirement. By providing for the clearing of such intraday repos in the Proposed Rules, as noted above, there is an argument that CMESC could bring them within the transaction submission requirement more generally, even for market participants that are not CMESC Members. This could mean that entities who are clearing members of FICC and engage in intraday (T+0) repos may be required to become Members of CMESC, as such transactions cannot be cleared at FICC, or otherwise risk running afoul of the transaction submission requirement.

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27 SEC Rule 17ad-22(a))

28 Pursuant to SEC Rule 19b-4, self-regulatory organizations registered with the SEC (such as clearing agencies) must file proposed rule changes with the SEC. Upon submission the SEC then reviews and approves the proposed rule changes, or denies the proposal. The rule filings are generally subject to public notice and comment, giving the industry the opportunity to react to, and have input on, the proposed rules.

29 SEC Rule 17ad-22(a))

30 Proposed Rule 202(b).

31 Proposed Rule 1504(d).

32 CME Group, U.S. Treasury and Repo Clearing Services Overview (Q1 2025, available here).

33 *Id.*

CMESC should clarify in its Proposed Rules that the transaction submission requirements under Proposed Rule 202 do not apply to transactions that cannot be cleared at CMESC (e.g., a type of transaction that is clearable at a different clearing agency but not CMESC) or transactions that are entered into by a direct participant that is not a Member of CMESC but is a member of a clearing agency that does not offer such transaction type for clearing. Otherwise, CMESC would effectively be able to force persons to become members of CMESC, even if they would not voluntarily do so, or prevent them from being a liquidity provider in those products. The SEC should similarly seek to clarify this more limited scope of its rules, which otherwise could have the effect of potentially forcing market participants to become members of all Clearing Agencies.

FIA would also invite the SEC to consider adopting an approach to Treasury clearing that aligns with the CFTC's framework for mandatory clearing. Specifically, under CFTC rules, the CFTC determines the types of transactions subject to the clearing requirement with input from DCOs that will clear those products.[34] Products not accepted for clearing by a DCO would fall outside the scope of the mandate. A similar approach by the SEC for Treasury clearing would provide greater clarity and consistency across market participants by allowing the SEC to define the scope of Treasury transactions subject to the transaction submission requirement, and permitting clearing venues to determine which of those transactions to offer to its members for clearing, so that the SEC can ensure a more predictable and harmonized implementation of the transaction submission requirement.

c. CMESC should clarify that pursuant to the Proposed Rules a transaction may continue bilaterally if that transaction is rejected from clearing.

CMESC Rule 202(c) provides that, if a transaction subject to the transaction submission requirement is rejected, "the Member shall comply with its obligation under paragraph (b) of this Rule 202 in another manner." This rule could be read to imply that the requirement for a direct participant to submit eligible secondary market transactions for clearing is actually an obligation to ensure that such transactions are accepted for clearing in all circumstances.

Consistent with the plain reading of the SEC's transaction submission requirement, FIA understands SEC rules may allow a transaction to continue bilaterally, including where the failure to clear is the result of a cause outside the control of the Member and its customer, such as technical or communication disruptions, malfunctions, or errors including cyber and other technological outages, prevents the transaction from being submitted to, accepted by, or novated to a clearing agency for clearing. Proposed Rule 202(c) should be clarified to read consistently with this understanding, and accordingly, market participants should be able to continue such transactions bilaterally in their discretion in accordance with applicable law, particularly where market disruptions require bilateral execution to meet the liquidity needs of the Treasury markets.

d. CMESC should allow bank branches to obtain membership without subjecting the entire bank to the transaction submission requirement.

FIA members are concerned that preventing the ability of banks—particularly banks with non-U.S. operations—to participate through their branches or agencies and forcing the transaction submission requirement on the entire bank, including all branch locations throughout the world, could have significant consequences which have not been properly identified or considered.

If an entire non-U.S. banking entity for a Member were to be subject to CMESC's rules globally, including the transaction submission requirement, customers of the banking entity worldwide that engage

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[34] See 17 CFR 39.5.

in Treasury repos with the banking entity would be required to become Members or Users of CMESC in order to clear such repos. These customers might not be able to become CMESC Members or Users.

This scoping might also disincentivize non-U.S. banks from directly participating in the cleared Treasury market to the same degree as they might otherwise were they able to obtain limited access through their U.S. branches and agencies. The effective restriction imposed by this membership feature, preventing banks from adopting a limited clearing participation in CMESC's through use of branches, to the extent it discourages overall participation in CMESC's clearing services, risks undermining CMESC's obligation under SEC Rule 17ad-22(e)(18)(iv)(C) to have appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in U.S. Treasury securities.

The Proposed Rules should also include operational procedures to facilitate different branches accessing, settling and being liable for transactions submitted through the member branch.[35]

e. CMESC should amend its rules to future-proof the implementation of the transaction submission and membership requirements by explicitly incorporating any SEC interpretations or guidance relating to the transaction submission requirement into Proposed Rule 202.

Treasury clearing is evolving and there is active engagement by the industry, including FIA, with the SEC to clarify or request interpretations with respect to particular aspects of the transaction submission requirement (e.g., with respect to the inter-affiliate exemption, mixed CUSIP repos, and the cross-border application of the transaction submission requirement) where we expect further SEC guidance to be forthcoming. Similarly CMESC should draft the eligible membership rules in such a way that it would automatically incorporate any SEC relief or interpretation regarding the scope of the cross-border application of the transaction submission requirement (i.e., where the SEC provides specific clarification that a "direct participant" is intended to refer to a particular branch of the Member, and not the Member as a whole).

VII. CMESC should consider whether its access models are compatible with future potential cross-margining solutions between CMESC and CME.

Cross-margining has the potential to significantly reduce the costs of, and enhance access to, central clearing for Treasury security transactions and certain Treasury and interest rate futures that are currently cleared by CME, by allowing initial margin requirements to reflect the risk of its combined portfolio. Currently CME has a cross-margining arrangement in place with FICC permitting clearing members to have their initial margin requirements at FICC and CME calibrated in a way that recognizes the risk offsets across related positions in CME futures and Treasury transactions cleared through FICC,[36] and we understand that FICC and CME plan to expand cross-margining to customers clearing through an FCM at both clearing houses as well. We further understand that CME and CMESC may similarly consider providing cross-margining between correlated products cleared at CME and CMESC. Allowing market participants to avail themselves of cross-margining would make the posting of margin more efficient, thereby reducing the cost of clearing.

The ability of a clearing member to quickly and efficiently close out transactions of its customers across clearing venues is critical to the proper functioning of any cross-margining arrangement. As discussed above, there are significant concerns regarding the ability of Members to close-out Users'

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[35] See e.g., 2002 ISDA Master Agreement, Section 10.

[36] *See* The Amended and Restated Cross-Margining Agreement between FICC and CME dated January 22, 2024 (referred to herein as the "**Amended and Restated XM Agreement**"), available at: https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_cme_crossmargin_agreement.pdf.

positions under the Proposed Rules, as well as the speed with which they may close-out even if they are permitted by CMESC to do so.[37] The inability to simultaneously close out positions upon an event of default would present an insurmountable impediment from a risk management perspective.

CMESC should provide an explanation of how it would expect to establish and support a cross-margining solution between CME and CMESC that is made available to their respective customers and Users. In particular, we urge CMESC to demonstrate that it has considered how to resolve the regulatory, operational and risk management concerns that may result from the asymmetrical nature of the interaction between FCM clearing members at CME and Members providing a guarantee of User positions on CMESC.[38]

VIII. CMESC should amend its rules to provide an exemption from the transaction submission requirement for repurchase transactions that would violate applicable CFTC requirements if cleared pursuant to the Proposed Rules, while also taking steps to enhance the Proposed Rules to accommodate compliance with applicable CFTC requirements.

a. CMESC should adopt an applicable law exception from the transaction submission requirement.

The CEA and the CFTC regulations thereunder establish a comprehensive customer protection program that requires FCMs to hold customer assets in segregated accounts by the following account classes: (1) futures customer funds; (2) cleared swaps customer collateral; and (3) the foreign futures secured amount.[39]

CFTC Rule 1.25 allows FCMs to invest customer funds held in such customer accounts in specific types of instruments, including U.S. Treasury securities, and further permits the use of repurchase transactions to make such investments provided that such transactions meet certain conditions ("**Rule 1.25 Repos**").[40] As detailed below, the conditions of CFTC Rule 1.25, as well as the segregation requirements applicable to FCMs under CFTC Rules 1.20, 22.2, and 30.7 are in many cases incompatible with the Proposed Rules.[41]

Because certain of the inconsistencies between the CFTC Rules and the Proposed Rules are wholly outside the control of CMESC, as detailed below, we would request that CMESC amend Proposed Rule 202 to exclude from the transaction submission requirement any transactions whose submission to CMESC would cause the Member or User to be in violation of applicable law (the "**Applicable Law Exception**").[42] The Applicable Law Exception would apply until such time as CMESC, the SEC and the CFTC can coordinate to resolve the conflicts presented by the application of the transaction submission requirement in the context of Rule 1.25 Repos, and to the extent the SEC believes that SEC-level relief is also necessary, FIA also requests that the SEC provide such relief.[43]

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37 See Section I.a above.

38 These clarifications are consistent with CMESC's obligation under SEC Rule 17ad-22(e)(1) to provide for a well-founded, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.

39 See CFTC Rules 1.20, 22.2, 30.7.

40 See CFTC Rule 1.25(d).

41 See CFTC Rules 1.20, 1.25, 22.2, 30.7; Proposed Rules 504, 507, 513, 1507(b) as well as CMESC Procedure 4-4(b).

42 CME Group similarly requested an exemption for DCOs from the SEC's transaction submission requirement based in part on irreconcilable conflicts with CFTC Rule 1.25. See CME Group, Comment Letter on SEC "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, File Number S7-23-22 (Dec. 27, 2022, available here).

43 While we expect CFTC relief to be forthcoming, we would encourage CMESC to engage with the CFTC on this issue in support of such relief and to work with the CFTC and FIA to develop a clearing model that will allow FCM's to access clearing

Conflicts requiring application of the Applicable Law Exception include:

i. Permitted Counterparty Restriction.

Pursuant to CFTC Rule 1.25(d)(2), an FCM may only enter into Rule 1.25 Repos with permitted counterparties and a clearing agency currently does not qualify as a permitted counterparty to a Rule 1.25 Repo. The SEC has suggested that an FCM may clear as a customer under an agency clearing model to avoid having a clearing agency as a counterparty for Rule 1.25 Repos.[44] Even assuming the CFTC would agree with the SEC's suggested interpretation, the lack of an agency clearing model under the Proposed Rules would make it impossible for an FCM to clear Rule 1.25 Repos as a User. Additionally, because of the permitted counterparty restriction in current CFTC Rule 1.25(d)(2), an FCM would not be able to self-clear Rule 1.25 Repos as a Member.

ii. Counterparty Concentration Limit.

Pursuant to CFTC Rule 1.25(b)(3)(v), Rule 1.25 Repos and cash transactions entered into pursuant to CFTC Rule 1.25 with any one counterparty may not exceed 25 percent of total assets held in segregation by the FCM. Because CMESC would be the counterparty to all Rule 1.25 Repos cleared pursuant to the Proposed Rules, positions held at CMESC would be aggregated for purposes of the 25 percent concentration limit. Accordingly, the Applicable Law Exception should apply.

b. CMESC should take steps to accommodate compliance with applicable CFTC requirements.

There are other inconsistencies between the CFTC Rules and the Proposed Rules for which CMESC may be able to amend or provide clarification to the Proposed Rules that could serve to mitigate or eliminate those inconsistencies, as further detailed below. To the extent CMESC is unable to resolve these issues to the satisfaction of FIA members, then as with the inconsistencies that are wholly outside the control of CMESC, we would expect that the industry and FIA members in particular would need to rely on the Applicable Law Exception until such time as the CMESC, the SEC and the CFTC can coordinate to resolve the identified conflicts.[45]

i. Prohibition on Use of Customer Funds as Margin.

While an FCM may invest customer funds pursuant to a Rule 1.25 Repo, such Rule 1.25 Repo would not itself constitute customer property and the proceeds of such Rule 1.25 Repo once received by the permitted counterparty, in this case CMESC, would constitute settlement proceeds and not customer funds. CFTC Rules would not permit the FCM to use customer funds to margin or otherwise collateralize the FCM's obligations under the Rule 1.25 Repo. This is because CFTC Rules prohibit an FCM from granting a lien on customer funds, or permitting the use thereof to secure or extend the credit of, any person other than such customer.[46] In the context of a

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for these types of transactions so that their Customers can benefit from the enhancements that clearing Rule 1.25 Repos would provide.

[44] Specifically, the SEC suggested in the preamble to the final rule adopting the transaction submission requirement that FCMs could use an agency model where the FCM "would essentially 'give up' its trades to a direct participant for submission without becoming a counterparty to the [clearing agency], which they believed should be consistent with the FCM's obligations under Rule 1.25(d)(2)." 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, 2,735 (Jan. 16, 2024).

[45] As with the issues outside the control of CMESC, we would encourage CMESC to engage with the CFTC and SEC, as applicable, in support of any necessary relief and to work with the SEC, CFTC, and FIA to develop a clearing model that will be consistent with FCM obligations.

[46] See CFTC Rules 1.22(a), 22.2(d)(2) and 30.7(f)(3).

Rule 1.25 Repo the credit being secured would be that of the FCM either as User or, for those self-clearing, as Member.

Accordingly, in order for an FCM to engage in Rule 1.25 Repos pursuant to current CFTC Rule 1.25, the FCM could not use its customer's funds to post as collateral or margin. If the FCM cleared Rule 1.25 Repos as a Supported User, its authorizing Member would need to either finance and post the Member's own funds or use the FCM's own funds to post as collateral with respect to the FCM User's transactions, and if the FCM cleared Rule 1.25 Repos as an Independent User or as a Member (on a self-clearing basis), the FCM would need to use its own funds to post as collateral. The commercial viability of these approaches is unclear, although it is clear that this solution would be more expensive than a bilateral repurchase agreement. The Proposed Rules would also need to clarify that any collateral posted in support of Rule 1.25 Repos by an FCM would be identified as not being customer funds.[47] This may require several amendments to the Proposed Rules; for example, Proposed Rule 513 treats margin posted by a Member on behalf of a Supported User as property of the Supported User, which could be problematic as the Proposed Rules do not distinguish between customer funds of the FCM and its proprietary assets. Even where a Member self-clears such transactions, the Proposed Rules would need to ensure that any margin posted is not treated as the FCM Member's customer funds.

Pursuant to CFTC Rule 1.25(d)(7), securities and cash transferred to an FCM under a Rule 1.25 Repo must be held with a permitted depository, which includes a DCO, a bank or DTC. A Clearing Agency such as CMESC and certain Members such as securities broker-dealers do not qualify as permitted depositories. CMESC would therefore not be eligible to hold any margin that constitutes customer funds (even if that were ultimately permitted notwithstanding the immediately preceding paragraph), nor would Members that authorize Supported Users but are not permitted depositories be able to hold OES or such margin in connection with a cleared Rule 1.25 Repo.

ii. Support for Separate Account Class Structure

Pursuant to CFTC Rules 1.20, 22.2, and 30.7, an FCM may not commingle customer funds, including cash and securities received pursuant to a Rule 1.25 Repo, with either the proprietary assets of the FCM or the assets that the FCM holds for a different account class (i.e., futures, foreign futures, cleared swaps), including any such assets received in connection with a Rule 1.25 Repo investing such customer funds of a different account class.

Accordingly, CMESC should clarify that its rules permit separate margin portfolios and accounts for the same User or Member in respect of Rule 1.25 Repos such User or Member clears using its proprietary assets or customer funds of a different account class, such that OES, cash and securities would be settled on a separate and gross basis for each such account. For the reasons discussed above, margin may also need to be settled separately. Furthermore, certain Users and Members may determine that they would not permit netting across these accounts even in the event of a Member or User default. CMESC should therefore offer an option to treat each of these accounts on a gross basis, and further confirm that in the event of an FCM User insolvency or FCM Member insolvency (for self-clearing Members) CMESC will not net across those separate accounts if that is required by the Participant.

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[47] Confirmation of treatment of OES as settlement, as discussed above Section IX.a would be helpful in this regard. Note that initial margin and OES to the extent held by or paid to the Member for a Supported User would require the Member to be a permitted depository under Rule 1.25, and as discussed above would require either relief from the CFTC or application of the Applicable Law Exception. Because all Users and Members settle cleared transactions with CMESC directly, a self-clearing Member clearing such Rule 1.25 Repos should not need to be a Permitted Depository (including for purposes of OES assuming CMESC is able to confirm that these payments would be settlement), although the general restrictions on use of customer funds to margin or otherwise secure Rule 1.25 Repos would apply as discussed above.

IX. CMESC should confirm that it will obtain legal opinions in respect of matters that have critical risk management or capital effects and make such opinions available to Participants.

Providing the opinions detailed below is consistent with CMESC's obligations under SEC Rule 17ad-22(e)(1) and (e)(23)(ii) to provide for a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions, as well as to provide Participants with sufficient information to enable them to identify and evaluate the risks, fees and other material costs they incur by participating in CMESC's clearing services.

a. OES as settlement.

We understand OES is viewed by CMESC as a settlement payment rather than posted margin, which is important for Participants' capital treatment of OES amounts (in line with the requirements set out by banking regulators).[48] However, while this explicit statement is helpful, Participants wishing to be confident that they can treat OES as settlement for accounting and capital purposes generally would require reasoned legal analysis reaching this conclusion. Accordingly, we urge CMESC to obtain, and make available to all Participants on a reliance basis, a reasoned legal opinion from outside counsel, in which counsel opines with (at least) a "should" level of comfort that cash transferred as OES will be treated as settlement payments rather than posted margin.[49]

b. Bankruptcy remoteness.

It is not clear from the Proposed Rules' description of the margin recordation and custodial accounts that Member and User assets held at CMESC would be held in a "bankruptcy remote" manner (i.e., that such assets would not form part of CMESC's estate in the event of CMESC's insolvency). This is important in the context of a securities clearing agency, as compared to the DCO context. Although the bankruptcy rules in 17 CFR Part 190 (the "**Part 190 Rules**") generally provide that each member of the clearing organization will have separate claims against the clearing organization with respect to customer property that is member property (and which have priority over unsecured creditors of the DCO's bankruptcy estate),[50] these rules do not apply to a securities clearing agency such as CMESC. Instead, CMESC would need to rely on standard bankruptcy remoteness principles in order to achieve effective bankruptcy remoteness for the assets of the Participants. Accordingly, we urge CMESC to obtain, and make available to all Participants on a reliance basis, a reasoned legal opinion from outside counsel, in which counsel opines that the assets of Members and Users held with CMESC would be considered bankruptcy remote consistent with the views expressed by FIA in the advisory paper entitled "Arrangements Necessary to Support a Positive Bankruptcy Remoteness Conclusion Under the Cleared Transaction Rules of US Basel III With Respect to Collateral Posted by a Clearing Member to a Central Counterparty."[51]

c. Enforceability of rules against Members and Users.

CMESC should obtain legal advice regarding the enforceability of the Proposed Rules under local law for any jurisdiction in which a Participant (including any User) is organized to ensure that CMESC's default management actions, particularly its ability to close out and net a Participant's transactions, would

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48 See SR 17-7: Regulatory Capital Treatment of Certain Centrally-cleared Derivative Contracts under the Board's Capital Rule (available here) (detailing Federal Reserve, OCC and FDIC joint guidance on this topic in the cleared derivatives context); This position is also supported by Proposed Rule 1504(b), which provides that payments in satisfaction of OES obligations are deemed settled to market (and not posting of collateral).

49 See also Section VIII.b.i discussing impact of the OES determination on the ability of an FCM to post margin.

50 17 CFR Part 190.19(a).

51 Available here (October 31, 2013).

be enforceable, including in the event of such Participant's insolvency. CMESC should make these opinions available to all Participants on a reliance basis.

CONCLUSION

As explained in detail above, FIA has serious concerns regarding the capital and risk management implications of the Proposed Rules and, in many cases, the changes to the Proposed Rules that are discussed will also align them with the requirements under Rule 17ad-22(e)(18)(iv)(C) to ensure appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions. Further, because the Proposed Rules conflict with CFTC regulatory obligations applicable to FCMs, the FIA respectfully requests that CMESC provide requested relief and clarifications, including an Applicable Law Exclusion that would apply until such time as the CMESC, the SEC and the CFTC can coordinate to resolve the conflicts presented by the application of the transaction submission requirement to FCMs, and to the extent the SEC believes that SEC-level relief is also necessary, FIA also requests that the SEC provide such relief.

Thank you for your consideration of these comments. If the Commission or any member of the staff have any questions regarding the matters discussed herein or need any additional information, please contact me at alurton@fia.org or 202.466.5460.

Respectfully submitted,

Allison Lurton
General Counsel and Chief Legal Officer