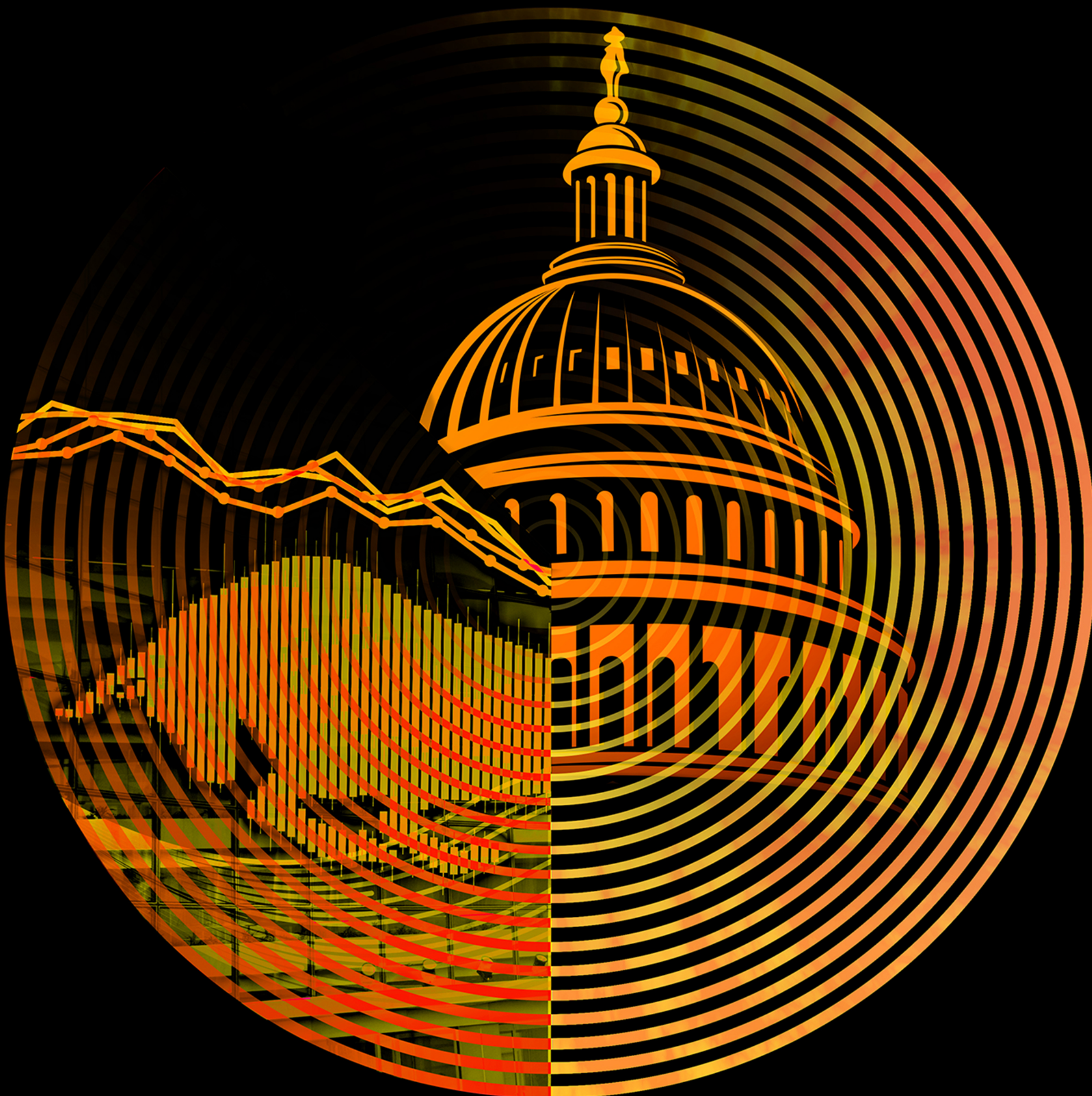


Final rule on US Treasury clearing

May 2024

Center *for*
Regulatory Strategy
US

Time for fundamental risk management and operational changes to the US Treasury market

On December 13, 2023, the Securities and Exchange Commission (SEC) adopted final amendments requiring firms to clear eligible Treasury securities transactions to a central clearing counterparty, such as the Fixed Income Clearing Corporation (FICC). Regulators consider central clearing more robust than bilateral clearing since it reduces counterparty risk and limits contagion. Expanding central clearing in US Treasuries is part of a package of reforms SEC Chair Gary Gensler is pursuing to bolster the US Treasury market.

In a speech just weeks before the SEC finalized the rules, Chair Gensler described a "fabric of regulation" intended to "reduce risk across [the US Treasury market] in normal and stressed times."[1] Since December, the SEC has finalized other pieces of Chair Gensler's agenda designed to reform the US Treasury market, including expanding the scope of entities required to register with the SEC and the Financial Industry Regulatory Authority (FINRA) as dealers.

Similar to the T+1 transition, implementing central clearing is likely to be a heavy lift for firms (i.e., broker-dealers, banks, hedge funds, covered clearing agencies) throughout the industry. In an effort to help facilitate a smooth implementation of central clearing, firms can look to the lessons learned from their transition to T+1—not necessarily in terms of the solutions deployed, but in terms of planning, overall approach, and mindset to address a significant regulatory change. Instead of viewing this as another regulatory and operational mandate to adhere to, the Treasury clearing requirements can be viewed as an opportunity to invest in future business, strengthen existing operating and technology infrastructures, and attract new customers in a saturated market.

Rule components and compliance timeline

The rules package consists of two important sets of amendments: (1) amendments to Rule 17ad-22 establishing standards for covered clearing agencies and (2) changes to the reserve requirement formula in Rule 15c3-3a.

SEC Rule 17ad-22 amendments: Standards for Clearing Agencies

These amendments require Covered Clearing Agencies (CCAs) (e.g., FICC—although nothing in the final rule prevents other CCAs to emerge) to establish, implement, and maintain policies and procedures that necessitate:

- Any direct participant of CCAs to “**submit for clearance and settlement all the eligible secondary market transactions**” to which the participant is a counterparty.
- **Identifying** and **monitoring** direct participants’ transactions submissions for clearing as well as how the clearing agency would **address a failure to submit transactions.**
- **Facilitating access to clearance and settlement services** of all eligible secondary market transactions in US Treasury securities, **including those of indirect participants.**
- **Calculating, collecting,** and **holding margin** for **transactions in US Treasury securities** submitted on behalf of an indirect participant separately from those submitted on behalf of the direct participant.

SEC Rule 15c3-3a amendments (compliance date March 31, 2025): Formula for determining customer and proprietary accounts of broker-dealers (PAB) account reserve requirements

Permits **margin required and on deposit** at CCAs providing central counterparty services for US Treasury securities to be included by broker-dealers as a **debit in the customer and PAB reserve formulas,** subject to certain conditions.

Dec. 13, 2023

“SEC Adopts Rules to Improve Risk Management in Clearance and Settlement and Facilitate Additional Central Clearing for the U.S. Treasury Market”[2]

2024

Mar. 11, 2024

DTCC submits regulatory rule filing to “Modify the GSD Rules to Facilitate Access to Clearance and Settlement Services of All Eligible Secondary Market Transactions in U.S. Treasury Securities”

Mar. 14, 2024

DTCC submits regulatory rule filing 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”[3]

2025

Mar. 31, 2025

FICC implementation of Government Securities Division rulebook updates and effective dates for 15c3-3a changes

Dec. 31, 2025

Rule changes must be effective for purchase and sale or cash transactions

2026

June 30, 2026

Rule changes must be effective for repurchase (repo) agreements

The importance of central clearing to a developed capital markets system

A strong government securities market is a cornerstone of effective US fiscal and monetary policy. The US Treasury market is the deepest and most liquid market in the world, central to not just the US economy but global capital markets.[4] As an investment product, US Treasuries are a benchmark for investors globally and a critical component in US economic power. Against the backdrop of global tensions and increasing multinational factions, there are regional efforts to move away from the US dollar as the primary alternative or reserve currency in Africa and Asia. The strategic importance of the US Treasury cannot be overstated in the context of US global economic policy and the overall health of the US dollar.

It is with this context Chair Gensler has introduced long-anticipated reforms in an effort to increase efficiencies and reduce systemic risk across the US Treasury market by widening the scope of US Treasury transactions requiring central clearing.

Today, it is estimated that up to 87% of US Treasury secondary market transactions are settled bilaterally, away from central clearing.[5] Bilateral settlement increases risk across the market by directly exposing firms to their counterparties. The central clearing model is perhaps more complex, but the benefit is realized by many parties as the associated risk is spread across the market when a transaction is cleared centrally.

The exposure faced by each dealer was highlighted to Treasury markets, participants, and regulators during the "dash for cash" in spring 2020. A large increase in the number of sellers of US Treasuries affected available liquidity in response to the market crash at the outset of the COVID-19 pandemic. Additionally, the collapse of Signature Bank and Silicon Valley Bank in March 2023 revealed the contagion concern, as investors piled into US Treasuries.

Central clearing as a means of reducing systemic risk is not a new concept. Netting and central clearing of equities and other fixed-income securities has long been established across the US capital markets ecosystem, such as with Dodd-Frank and the requirement to centrally clear a larger number of credit default and interest rate swaps. It is considered among the most efficient and effective means of reducing counterparty risk and increasing transparency across securities settlement. The introduction of mandatory central clearing for a wide range of Treasury and repo transactions was, therefore, not unexpected and indeed, seems the prudent means of reducing systemic risk.

Centrally clearing a greater range of transactions is designed to reduce counterparty credit risk, enhance market liquidity, and offer a new way for firms to engage with prospective clients, if it is deemed firms must establish a multi-provider clearing arrangement to support their Treasury market activity.

FICC remains the primary CCA for US Treasuries and fixed-income products today, and firms will now need to prepare their membership applications to continue to offer clearing and settlement facilities for US Treasuries to their clients. Yet there is nothing preventing the establishment of more CCAs to offer clearing and settlement services to market participants. While the regulatory requirements are complex and barriers to entry steep, a number of organizations have announced their intention to explore creating a CCA for US Treasuries. Today, swaps are cleared through one of six different CCAs, a clear precedent for multiple clearing agencies for one asset class, and valuable competition to market participants.

While there are certainly benefits, market participants do not believe that this transition will be easy. This change comes hot on the heels of the T+1 transition, which is already causing significant changes across the operations and technology processes for global investors, and with a shorter implementation timeline.

The effects of this new rule are expected to be widespread and profound for firms across the world. While preparing for the new requirements will be a large effort, there is also an important strategic opportunity for firms.

Chair Gensler's remarks on the Treasury markets

Last November at the Securities Industry and Financial Markets Association's (SIFMA) annual meeting, Chair Gensler conveyed the importance of Treasury markets as both the basis of capital markets and integral to the Federal Reserve's facilitation of monetary policy. Chair Gensler alluded to past "shudders" or "jitters" of the early 1980s in Treasury markets that were brought about by nonbank Treasury dealers' failures or emanated from the repo markets. Specifically, Chair Gensler referenced the failure of a dozen nonbank Treasury dealers to which Congress responded by passing the Government Securities Act in 1986, which provided the Treasury Department and the SEC with regulatory authority over Treasury markets.

Gensler noted these "Jitters over time" as a defining characteristic of Treasury markets and highlighted that these jitters are the result of bank and nonbank intermediaries using leverage, with emphasis on the prime brokerage relationships.

Additionally, Chair Gensler identified "the use of leverage by intermediaries" as another relevant characteristic of Treasury markets and highlighted that intermediaries and other market participants fund their positions in Treasuries through the repo markets; the leverage is primarily facilitated by prime brokerage relationships between hedge funds, nonbank intermediaries, banks, and broker-dealers.

As Chair Gensler concluded his address, he communicated the breadth of reforms he is pursuing to limit Treasury market volatility, which includes registration of dealers, registration of trading platforms, data collection, and central clearing.

Transformation opportunity for firms

In today's dynamic business landscape, firms are challenged to adapt to changing market conditions, technological advancements, and evolving regulatory requirements. Amid these challenges, strategic transformational opportunities emerge for forward-thinking organizations to not only survive but thrive in the face of complex change.

When evaluating the required changes, it is clear the Treasury's clearing requirements come with a price tag (e.g., increasing the cost of doing business), and anytime there is an increase in costs, executives are put in the position to reevaluate how they respond to the changing market while also trying to simplify organizational processes and maximize returns.

This section considers areas firms may be able to strategically transform within their organizations while also implementing changes designed to satisfy the new Treasury clearing requirements.

- Strategy and business models
- Technology infrastructure
- Margin and customer reserve processes
- Risk management
- Governance and talent
- Repapering and onboarding
- FICC access
- Documentation
- Organizational structure—entities and inter- affiliate exemptions

1. Strategy and business models:

Firms should consider dedicating time to reevaluate and refresh their strategic objectives and the business models they wish to engage, including target customers, channels, pricing, and delivery models. An analysis of the Treasury clearing requirements reveals distinct variations in the strategy and business model impacts for existing member and nonmember firms. An overview highlighting these differences, to emphasize the tailored considerations for each of these scenarios, is provided below.

- **Nonmember firms:** The rule will create a heightened demand for access to clearing via one of FICC's clearing models (e.g., full-service member, sponsored member, prime broker clearing, correspondent clearing). Nonmember firms will need to first decide if they will seek sponsored access. If the answer is yes, they will need to evaluate "who" (e.g., direct members) they can work with to access central clearing indirectly. Nonmember firms should also consider the cost of doing business via a sponsored member model (e.g., clearing fees, spreads) and evaluate the impact of the anticipated increase of costs.

- **Member firms:** Dealers and banks may seek to maximize the return on their sponsorship undertakings. To leverage these benefits, member firms will need to review their potential sponsorship opportunities and consider the delivery model(s) (e.g., cost, procedures, agreements) they want to make available to nonmember firms seeking sponsorship.

2. Technology infrastructure

Firms should confirm their internal systems have the infrastructure to operate with speed and conciseness in a larger-scale clearing environment. Specifically, direct participants should determine whether their existing systems are fit to handle new requirements (e.g., execution of separate margin calculations) and reasonably ensure that there are systematic controls (e.g., real-time monitoring) in place to oversee and report on the updated processes. Indirect participants who are new to clearing should consider their overall implementation roadmap for the submission of trades and identify where technology can ease the expected increase in operational processing.

3. Margin and customer reserve processes:

Firms should review and update their existing margining processes to support the new requirement for FICC to calculate, collect, and hold margin amounts for a direct participant's proprietary US Treasury position (or "house") separately from the margin amounts for the direct participant's customer's US Treasury positions. Examples of margining processes include calculations, collection and payment, and reporting, as well as policies and procedures. A firm's method to compute customer reserve requirements will also need to be transformed to account for the requirement that broker-dealers hold required customer margin on deposit at a central clearing agency in the US Treasury market as a debit in the customer reserve formula, subject to certain conditions. In addition to reasonably ensuring computations are updated to account for the new debit, firms should also be running quality checks to help confirm the data feeds related to their calculations are complete and accurate.

4. Risk management:

A main target of the Treasury clearing requirements is to reduce the overall counterparty and systemic risk in the US Treasury market. Liquidity and collateral commitments/demands are also anticipated to expand due to the increase of trades requiring margin.Overall, firms should revisit their existing risk appetites and statements and expect to make amendments to their existing tolerances and thresholds across the different risk pillars (e.g., model risk, credit risk, liquidity risk, compliance risk).

5. Governance and talent:

Firms' operational teams, especially teams concentrated within the middle office, will need access to the appropriate firm subject-matter experts and training materials to expand their learning and development on both the new compliance requirements and the associated new or updated policies, procedures, and practices. Separately, firms should also assess the existing US Treasury-related roles and responsibilities across regions and functional support groups (e.g., offshore teams, third parties) and identify opportunities to modify existing responsibilities, merge responsibilities across various roles, or implement new responsibilities or roles.

6. Repapering and onboarding:

The SEC mandate will likely require existing and prospective agency clearing members to update their client paperwork and documentation as well as complete additional documentation with FICC to update their membership status, as applicable. Firms mandated by the ruling should not underestimate the effort required to complete the extensive repapering to support these changes. Unlike recent industry mandates, such as T+1, this is not an effort that firms can impose on their clients without negotiating and completing additional documentation. Firms should not wait to conduct analysis and implement changes with their clients. Implementing these documentation and membership changes will be a time-consuming process in an already busy timeline for compliance. This rule is anticipated to change the way that firms do business across the street—and FICC members need the documentation to account for this. The rules will likely mandate changes in booking models, as well as clearance and settlement processes. Firms should be prepared to work closely with their clients to implement these changes and make sure the requisite legal documentation and paperwork is in place to facilitate these changes. Members potentially will have to start new methods of clearing and settling trades with their clients—and thus may have to create additional legal documentation to implement new operational, margin, risk management, and booking models. Firms should consult both internal and external legal counsel to help ensure that changes to processes and booking models are reflected in documentation and paperwork for clients.

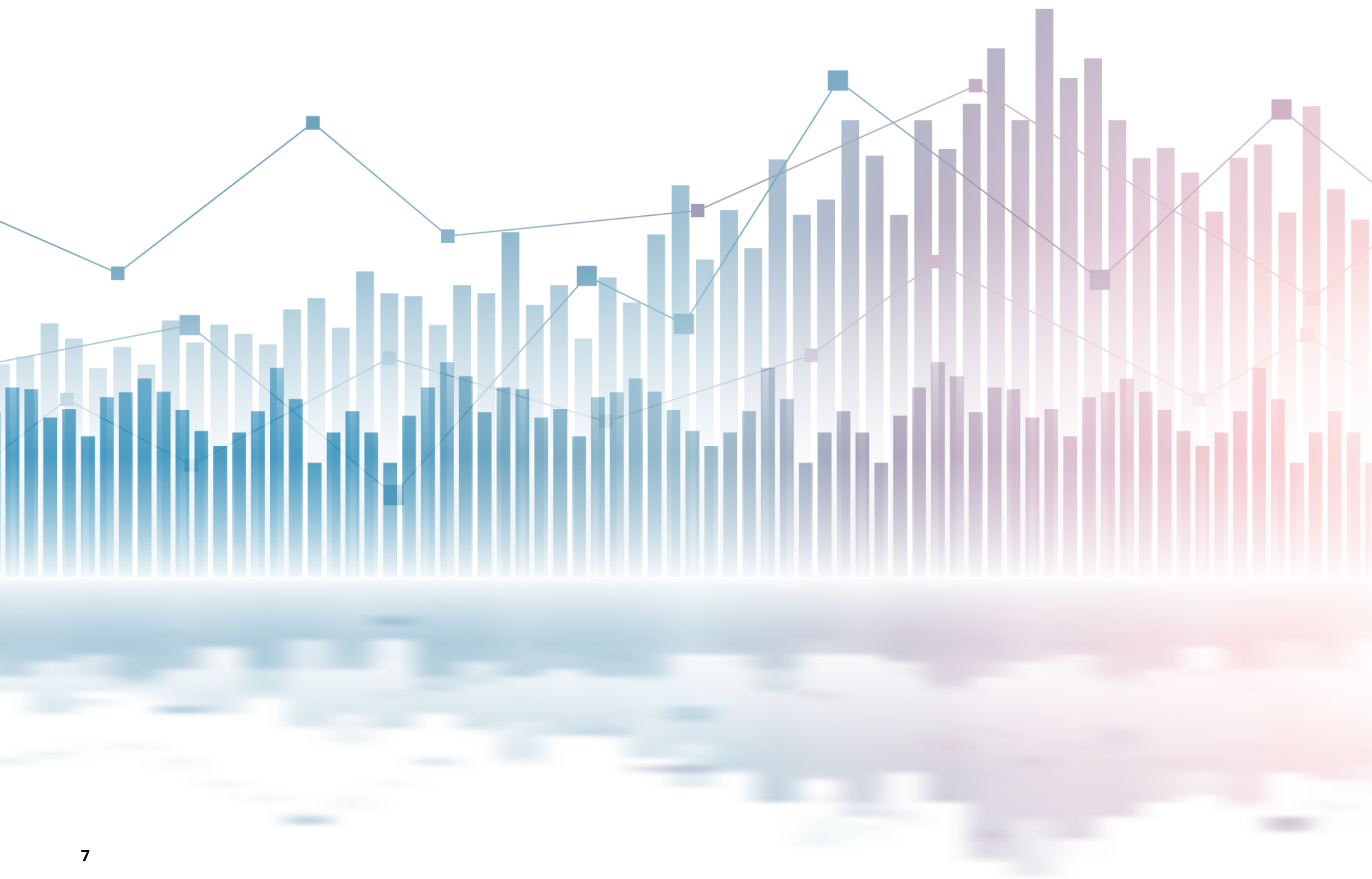
7. Establishing FICC access is a top priority:

Prospective FICC members have both short- and long-term priorities to address. In the short term, firms should organize their own access to FICC and evaluate if they have the operational capabilities to submit trades through the clearance and settlement processes. Over the next six months, firms should choose which access models they will offer to their clients to provide enough lead time to implement additional processes, infrastructure, and operational groups. Regardless of what modes of access firms elect to offer their clients, implementing access to FICC and building institutional knowledge of the existing processes and routines will be of vital importance to a successful transition.

Program mobilization—structure and impact assessments

Firms should understand the depth and breadth of the impact the final rules have on processes, workflows, and systems. Firms will require a client outreach campaign, target operating model work, legal documentation review, strategy review, risk management, tech analysis, infrastructure change, and compliance updates. Instead of considering simply how to adjust existing processes, it should be approached from both a top-down and bottom-up perspective beginning with an impact assessment.

The impact assessment should not only identify the required changes designed to comply with the final rules, but also the strategy for achieving compliance, controlling the message to clients and other stakeholders, and establishing a governance framework both to implement the changes as well as oversee its function under the new compliance requirements.



Impact assessment considerations

- **Margin:** Firms should identify existing parties and infrastructure for managing house and margin accounts and consider:
  - Do firms have an omnibus account for storing margin, regardless of whether it is cash or security margin?
  - What applications or services is your firm leveraging to manage margin?
  - What capabilities will your firm need in the future, and what net new capabilities will your firm need to implement?
  - How will the firm be able to collect margin in the future state and meet the requirements of the new FICC regulations, as well as the final rule?
- **15c3-3:** The PAB reserve formula applies to firms' proprietary securities accounts. Each firm has their own process and procedures for calculating the PAB reserve formula. FICC requires a certain balance to be held within the proprietary securities account:
  - How will your firm be able to update its 15c3-3 calculations and account for the additional margin required?
- **Understanding the scope of in-scope transactions and trade flows:** Firms and dealers should understand the population of in-scope transactions that will require clearing in the future:
  - How will your firm internally identify what transactions need to be centrally cleared through FICC?
  - How will your firm identify which process flows will be affected in the future state?
  - What documented trade flows and processes exist today, and how can these be leveraged for process redesign?
- **Business reporting:** Collaborate with operations and confirm current process and settlement flows for US Treasuries, and understand the key performance indicators (KPIs) and key risk indicators (KRIs):
  - What existing KPIs and KRIs can be leveraged in the future, and what new reporting capabilities are required?
  - How will the firm adjust risk appetites, existing thresholds, and policies to account for the new processes, and what metrics will be required to accurately assess this risk?
  - In the future state, how will you be able to track FICC submission rates on an ongoing basis?
- **Revised controls:** With new processes comes new control requirements to reduce operational risk:
  - What existing controls will need to be amended to account for the new transaction process flows?
  - What new controls will need to be introduced because of this new regulation?
  - What technology, people and culture, foundation, and process changes will be required to implement these controls?

Outputs of the impact assessment

- **Business requirements and strategy:** Outline baseline requirements defining the structural changes from the final rule on margining as well as centrally clearing cash transactions and repo agreements through FICC.

- **Inventory of processes and list of required changes:** Identify and define Treasury middle- and back-office settlement groups' operational flows and processes to determine the depth of impact from the final rule.

- **Inventory of affected technology systems and list of required changes:** Detail systems and platforms supporting margin management and transaction processing for US Treasuries, and assess where technical changes will be implemented.

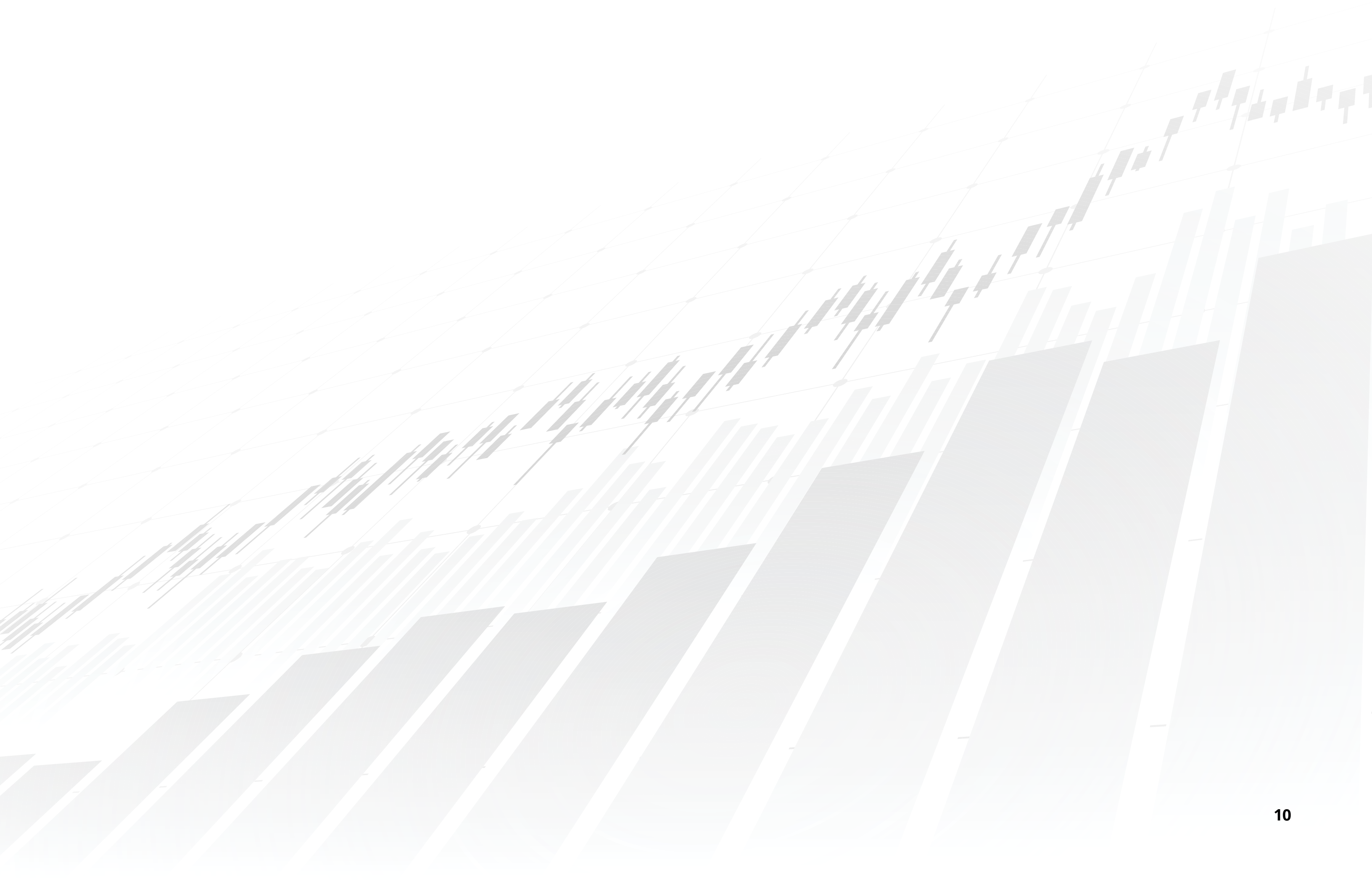
- **Funding estimates:** Evaluate the cost for development, testing, and implementation of required programmatic, technical, and operational changes for margin management as well as cash and repo transactions.

- **Front-office support and materials:** Conduct conversations with clients. Dealers and agents should be prepared to discuss the implications of this transition with their clients as soon as possible.

Conclusion

Mandatory central clearing for both repo and secondary market transactions for US Treasuries will make great strides toward de-risking the market—if correctly implemented, these should reduce both systemic and counterparty credit risks for dealers and market participants across the street.

This rule will broadly affect anyone investing in US Treasuries or using US Treasuries to fund their positions and activity. While there will be a significant uplift required for custodians and agent clearing members, the impacts for this transition will be felt beyond the custodial community. Firms will need to be prepared to promptly consider the impact of the final rules to their business and make the changes required to meet this new regulatory mandate. Margin changes, collateral, risk management, clearing and settlement, and documentation and papering of customers, as well as booking model updates, are expected to be a significant lift for US participants.



Contacts

George Black
Advisory Principal
Deloitte & Touche LLP
geblack@deloitte.com

Bob Walley
Advisory Principal
Deloitte & Touche LLP
rwalley@deloitte.com

Marjorie Forrestal
Advisory Principal
Deloitte & Touche LLP
mforestal@deloitte.com

Billy Dunne
Audit and Assurance Partner
Deloitte & Touche LLP
wdunne@deloitte.com

Peter Brown
Advisory Senior Manager
Deloitte & Touche LLP
petebrown@deloitte.com

Mara Gauger
Advisory Senior Manager
Deloitte & Touche LLP
mgauger@deloitte.com

Andrew Kisz
Advisory Senior Manager
Deloitte & Touche LLP
akisz@deloitte.com

Mike Jamroz
Independent Senior Advisor
Deloitte & Touche LLP
mjamroz@deloitte.com

Deloitte Center for Regulatory Strategy

Joshua Uhl
Managing Director
Deloitte & Touche LLP
juhl@deloitte.com

Meghan Burns
Manager
Deloitte & Touche LP
megburns@deloitte.com

Contributors

Henry Bourn | Kayleigh Schor | Alex Tsusaki | Matt Koudelka | Kris Kinsella | Jackson Miles

Endnotes

1. US Securities and Exchange Commission (SEC) Chair Gary Gensler, "'Fall Feelings: Treasury Markets' Efficiency and Resiliency' remarks before SIFMA," SEC, November 7, 2023.
2. DTCC Regulatory Rule Filing SR-FICC-2024-005, March 11, 2024
3. DTCC Regulatory Rule Filing SR-FICC-2024-007, March 14, 2024
4. DTCC, *Looking to the horizon: Assessing a potential expansion of U.S. Treasury central clearing*, September 2023.
5. 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," SEC Release 34-99149, December 13, 2023.

Center *for*
Regulatory Strategy
US

About the Center

The Deloitte Center for Regulatory Strategy provides valuable insight to help organizations in the financial services industry keep abreast of emerging regulatory and compliance requirements, regulatory implementation leading practices, and other regulatory trends. Home to a team of experienced executives, former regulators, and Deloitte professionals with extensive experience solving complex regulatory issues, the Center exists to bring relevant information and specialized perspectives to our clients through a range of media, including thought leadership, research, forums, webcasts, and events.

Deloitte.