January 2024

The SEC Approves Mandatory Clearing of Transactions in US Treasury Securities: *Issues for the Buy Side to Consider*

On December 13, 2023, the Securities and Exchange Commission (the "**SEC**" or the "**Commission**") voted 4-1 to approve *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* (the "**Clearing Rule**")[1] which requires the majority of transactions in U.S Treasury securities ("**USTs**"), including repurchase and reverse repurchase (or "repo") transactions in USTs, to be cleared via a central clearing agency ("**CCA**"). The Clearing Rule has significant implications for buy side participants in the market for USTs, and has been the subject of much comment and robust discussion around its impact and implementation.[2] Ultimately, the SEC made significant concessions from its original proposal based on market comments and concerns. Most notably, cash transactions in U.S. Treasury Securities involving buy side participants (*e.g.*, hedge funds, mutual funds, money market funds, etc.) are excluded from mandatory clearing. Additionally, the SEC adopted a phased implementation approach, with compliance for the clearing of repo transactions slated to be effective June 30, 2026.

We had previously noted the Commission's approval of the Clearing Rule for our clients.[3] This memorandum provides an overview of the key provisions of the Clearing Rule, together with some pertinent background and a summary of the important issues buy side participants should consider as they prepare for implementation, including the following:

- Access to CCAs, including consideration of give-up or "done away" transactions;

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[1] SEC Release No. 34-99149 (December 13, 2023), 89 Fed. Reg. 2714 ("**Final Rule**"). https://www.sec.gov/files/rules/final/2023/34-99149.pdf. Commissioner Hester Peirce voted against adoption.

[2] *See, e.g.*, Letter dated January 3, 2023, from Ann Battle, Senior Counsel, Market Transactions, International Swaps and Derivatives Association, Inc. ("**ISDA**") ("**ISDA Letter**"), *available at*: https://www.isda.org/a/XLxgE/ISDA-Response-SEC-Request-for-Comment-UST-Clearing.pdf; Letter dated December 4, 2023, from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association ("**MFA**") ("**MFA Letter**"), *available at*: https://www.mfaalts.org/wp-content/uploads/2023/12/MFA-Supplemental-Comment-Letter-on-Treasury-Clearing-Proposal-As-submitted-12.4.23.pdf; *see also* Letter dated December 23, 2022, from William C. Thum, Managing Director and Assistant General Counsel, the Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**") ("**SIFMA AMG Letter**"), *available at*: https://www.sifma.org/resources/submissions/standards-for-covered-clearing-agencies-for-us-treasury-securities-and-application-of-the-broker-dealer-customer-protection-rule-sifma-amg/. There has also been much reporting in the market press regarding the Proposal. *See, e.g.*, Securities Finance Times, *Industry associations urge review of Commission treasury clearing proposals* (January 10, 2023), *available at*: https://www.securitiesfinancetimes.com/specialistfeatures/specialistfeature.php?specialist_id=659&navigationaction=features&newssection=features.

[3] *See, SEC Approves Final Rule – Mandatory Clearing of Transactions in US Treasury Securities*, Seward & Kissel Client Alert (December 18, 2023), available at: https://www.sewkis.com/publications/sec-approves-final-rule-mandatory-clearing-of-transactions-in-us-treasury-securities/.

- Margin determinations, including concerns relating to "initial margin" and the availability of cross-margining;
- Counterparty and CCA risk, including customer protections;
- Relationship with dealer intermediaries, including documentation; and
- Implementation timing and sequencing.

Summary of the Clearing Rule – Overview

The impetus for the Clearing Rule can be attributed to three substantial disruptions in the UST market that have occurred in recent years: the October 2014 flash rally, the September 2019 repo market disruptions, and the Covid-19 shock of March 2020.[4] Consistent with the approach taken by U.S. regulators in addressing risks associated with derivatives markets following the 2008 financial crisis, the Clearing Rule advances central clearing as the most effective approach to reduce systemic risk related to the UST market and to provide market stability in times of stress.[5]

The Clearing Rule amends two sections of the Securities Exchange Act of 1934 (the "**Exchange Act**"). First, the Clearing Rule amends Exchange Act Rule 17Ad-22 to require CCAs to, (i) provide central counterparty services for all eligible secondary market transactions in USTs to which their direct participants are a counterparty, (ii) calculate, collect and hold margin for eligible secondary market transactions in USTs submitted on behalf of indirect participants separately from those submitted on behalf of direct participants, and (iii) facilitate access to clearing and settlement services for all eligible secondary market transactions in USTs to indirect participants.[6] Second, the Clearing Rule amends Exchange Act Rule 15c3-3a to allow margin required and on deposit at a CCA related to the clearing of eligible secondary market transactions to be included as a debit item in the customer reserve formula under the broker-dealer customer protection rules.[7]

Four Key Features of the Clearing Rule

1: Covered Clearing Agencies ("CCAs") must provide central counterparty services for all eligible secondary market transactions in U.S. treasury securities to which their direct participants are a counterparty.[8]

CCAs are required to establish criteria for participation that would require all direct participants in the CCA to clear all eligible secondary market transactions in USTs to which such direct participant is a counterparty.

The Clearing Rule defines "eligible secondary market transactions" in USTs to include the following categories of transactions:

- repurchase and reverse repurchase transactions in USTs by a direct participant ("Repo Transactions"); and

[4] The Commission expressly refers to these events in the Clearing Rule. *See* Final Rule at 2790-2791.
[5] *See, e.g.*, Final Rule at [ ]. SEC chair Gary Gensler also expressed his views about how central clearing will reduce risk in the press release accompanying the Final Rule. *See* SEC Press Release, *SEC Adopts Rules to Improve Risk Management in Clearance and Settlement and Facilitate Additional Central Clearing for the U.S. Treasury Market*, *available at:* https://www.sec.gov/news/press-release/2023-247.
[6] Final Rule at 2716-2717.
[7] *Id.* at 2717.
[8] *Id.* at 2722.

- "Cash Transactions," comprising both:
    - purchase and sale of USTs for direct participants by an interdealer broker; and
    - purchase and sale of USTs between a direct participant and a counterparty that is a registered broker-dealer, or government securities dealer or broker. Note, the SEC excluded purchase and sale of USTs between direct participants and buy side investors (including hedge funds, mutual funds, etc.) or levered accounts from the final definition.[9]

The Clearing Rule also provides an exemption from the clearing mandate for Repo Transactions and Cash Transactions between direct participants and counterparties that are central banks, sovereign entities, international financial institutions or natural persons.[10]

2: Covered clearing agencies must establish, implement, maintain and enforce written policies designed to calculate, collect and hold margin from direct participants separate from indirect participants (i.e., customers).[11]

In order to improve risk management of CCAs and promote access to clearing, the Clearing Rule requires CCAs to calculate, collect and hold margin for direct participants' proprietary positions separately and independently from the margin required from indirect participants that rely on direct participants for access to the CCA. In effect, indirect participants' positions are no longer netted against direct participants' positions prior to clearing, and customer (*i.e.*, indirect participant) collateral would be held in an omnibus account structure commingling collateral for all customers of a particular member (*i.e.*, direct participant).

This approach is similar in effect to the "legally segregated, operationally commingled" (or "LSOC") approach for cleared swaps. However, under the Clearing Rule, customer margin segregation is not intended to protect customers from "fellow customer risk", but rather to mitigate the risk of a direct participants' disorderly default. The Commission affords CCAs broad discretion to come up with the framework that works best for the products they clear, which as they acknowledge, could be something more closely aligned to LSOC where commingled customer margin cannot be used for loss mutualization.[12] Additionally, the Commission notes that the CCA's access to better and more robust information about the defaulting participant's exposure and positions may confer an advantage to the CCA in such a close out scenario, which is something the Commission might, in turn, see as creating an incentive for greater market participation in the clearing scheme.

3: Covered clearing agencies must establish appropriate means to facilitate more access to central counterparty services indirect participants.[13]

The third key element of the Clearing Rule requires CCAs to develop methods of access that would accommodate a larger and more varied cohort of indirect participants. The Commission acknowledges that the FICC's sponsored repo access models are currently unable to satisfy all the preferences and requirements of customers who are seeking to participate. The Commission notes, for example, that some market participants prefer to bundle trading and execution services, while others prefer an

[9] *Id.* at 2748.
[10] *Id.*
[11] *Id.* at 2755.
[12] *Id.* at 2754.
[13] *Id.* at 2760.

unbundled model.[14] The Commission also highlights the concern expressed by certain market participants regarding the discretion that direct participants are afforded under the FICC rules in deciding whether to submit customer trades for clearing. In particular, the Commission cites the example of direct members of FICC being unwilling to submit trades for indirect participants that have been executed away from the direct participants (*i.e.*, "done away" transactions), even though FICC's rules allow direct participants to submit such trades if they chose.[15] The Commission stopped short of prescribing specific access methods, but rather, mandates that CCAs develop "appropriate means" to facilitate (*i.e.*, encourage) access to the CCA's clearance and settlement services of all eligible secondary market transactions. Thus, the Clearing Rule affords CCAs significant discretion in devising solutions to allow indirect participants more access to their central counterparty services, without requiring direct participants to guarantee transactions that otherwise fall outside their risk appetite.

4: Broker-dealers are allowed to include a debit in the customer reserve formula under Rule 15c3-3a for margin delivered to a CCA for clearing eligible secondary market transactions in USTs.[16]

The fourth key element of the Clearing Rule allows regulated broker-dealers to use their customers' margin collected in connection with their broker-dealer (*i.e.*, prime brokerage) relationships to satisfy customers' margin requirements for cleared repurchase and reverse repurchase transactions in USTs. This is accomplished via an amendment to the Commission's broker-dealer customer protection rule that allows margin posted to FICC (or another CCA) to be included as a debit item in the customer reserve formula, thereby freeing up assets that can be used to satisfy the CCA's margin requirements. Absent such a rule, the increased margin requirements that would follow from an expanded clearing mandate would have to be satisfied by using broker-dealers' proprietary cash and securities, which would impose significant costs on the market and serve as a constraint on the market's capacity to support the clearing mandate.

The Clearing Rule imposes several conditions that have to be met in order for a broker-dealer to include customer margin held by the CCA as a debit item, including that such margin must:

- consist of either (i) cash owed to the broker-dealer's customer,(ii) U.S. Treasury securities held in custody by the broker-dealer to satisfy the customer's margin requirements for cleared transactions at the CCA or (iii) "qualified customer securities," meaning securities other than U.S. Treasury securities that are acceptable to the CCA;
    - this condition would require that (1) only customer assets be used to meet customer margin requirements for cleared transactions at the CCA, (2) any particular customer's assets be used exclusively to margin that customer's obligations at the CCA, and (3) the broker-dealer have delivered the customer's assets to the CCA.
        - Note, the Commission made a concession based on timing concerns raised during the comment period and will permit broker-dealers to deliver their proprietary securities to satisfy customer margin requirements to the CCA, if (i) the proprietary securities are U.S. Treasury securities only, (ii) the broker-dealer does not own or hold in custody cash, U.S. Treasury securities or "qualified customer securities" from the customer to satisfy the margin requirements to the CAA and

[14] *Id.* at 2756.
[15] *Id.*
[16] *Id.* at 2761.

(iii) the broker-dealer calls for additional margin from the customer to be delivered by close of business on the following day.[17]

- be calculated separately for each customer, and delivered by the broker-dealer on a gross basis for each customer; and
- be invested in U.S. Treasury securities with a maturity of one year or less.[18]

This important feature of the Clearing Rule is linked to the enhanced protections for customer margin discussed above, since customer margin held by broker-dealers cannot be delivered into the custody of a CCA unless that margin is segregated and used solely to cover customer obligations.

Implementation of the Clearing Rule will result in a UST market that will be very different from the current one, a market where the vast majority of transactions in USTs, both Cash Transactions and Repo Transactions, are cleared via one or more CCAs. While there are already many institutional investors and some larger hedge funds that clear their UST repurchase transactions, the requirements of the Clearing Rule will mean major changes for most of our buy side clients that trade UST repo in connection with their funding, balance sheet and treasury functions. The discussion in this article will focus on the implications of the Clearing Rule for Repo Transactions for those buy side clients, so that they may begin to prepare for this significant market shift.

UST Repo Clearing – A Brief Primer

Background – How does repo clearing work?

A proper assessment of the Clearing Rule's clearing mandate requires an understanding of the existing central clearing structure for the repo market and the terminology associated with the clearing of USTs. Currently, the Fixed Income Clearing Corporation ("**FICC**"), a wholly owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"), is the only CCA providing central counterparty services for repo transactions. FICC's Sponsored Membership model is the repo clearing model that provides perhaps the best example to illustrate.[19] Under this model, a cleared repo transaction involving a buy side end user starts just as a typical delivery-versus-payment (DVP) repo, with a dealer and an end user negotiating the terms of the transaction. Following negotiation, the transaction is novated (given up) to the CCA and the dealer, acting as the "sponsor" for its end user customer, facilitates the processing and operational functions with the CCA, including submission and settlement of the transaction. Thus, the transaction becomes one between the end user and CCA, with the sponsoring dealer intermediating. Notably, the sponsoring dealer guarantees the end user's performance to the CCA, just as a futures commission merchant does in the context of cleared futures contracts. This structure is consistent with clearing models in other asset classes, such as the OTC derivatives clearing model intermediated by a futures commission merchant.

What does repo clearing look like today?

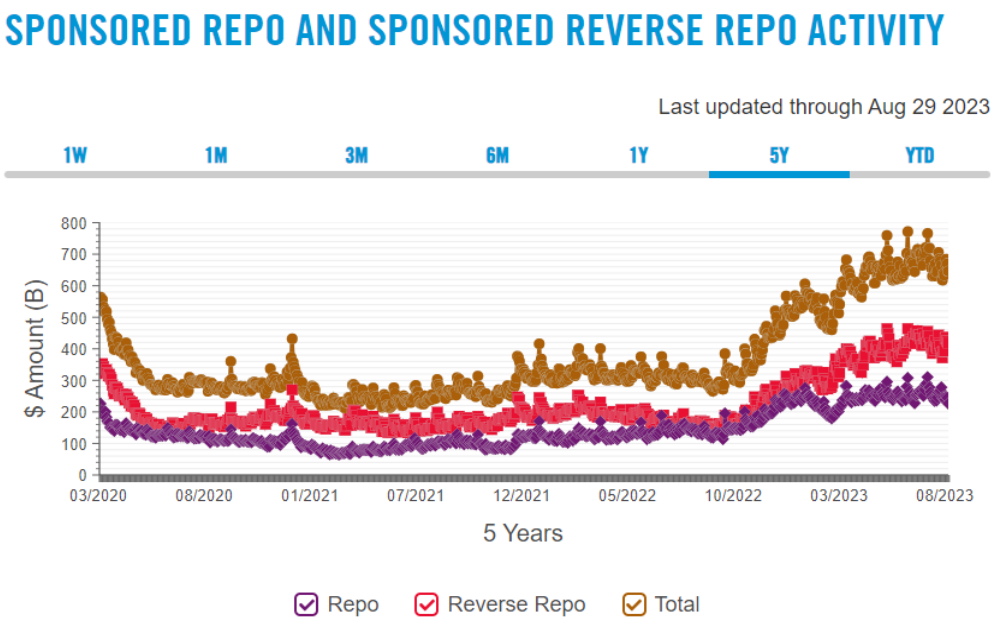
Under FICC's model, direct participants, also called "sponsoring members" (the "sponsoring" dealer described above), are comprised of major banks and broker-dealers. At the end of fiscal year 2022, there

[17] *Id.* at 2761-2763.
[18] *Id.* at 2765.
[19] Buy side participants can learn more about FICC's Sponsored Service on the DTCC website. *See* DTCC, Sponsored Service, *available at*: https://www.dtcc.com/clearing-services/ficc-gov/sponsored-membership.

were 35 sponsoring members.[20] Sponsoring members are given access to FICC's central counterparty services, and FICC's rules require sponsoring members to clear Repo Transactions only if their counterparty is another sponsoring member. This leaves a sizable portion of sponsoring member Repo Transactions cleared and/or settled outside FICC, which the Commission views as creating "contagion risk" to both FICC and the UST market.[21]

The market has taken steps on its own to promote and expand central clearing. In 2017, FICC expanded its central counterparty services to indirect participants or "sponsored members" (the "end users" described above) who are qualified institutional buyers.[22] Sponsored members gain access to FICC central counterparty services through their relationship to a sponsoring member. As noted above, sponsored members are not subject to mandatory clearing requirements under FICC rules. The 2017 expansion opened FICC central counterparty services to buy side firms, who make up the largest cohort amongst 2200+ sponsored members.[23] FICC also offers buy side participants access via their prime broker or a correspondent clearer, and registered investment companies are eligible to clear Repo Transactions directly.[24]

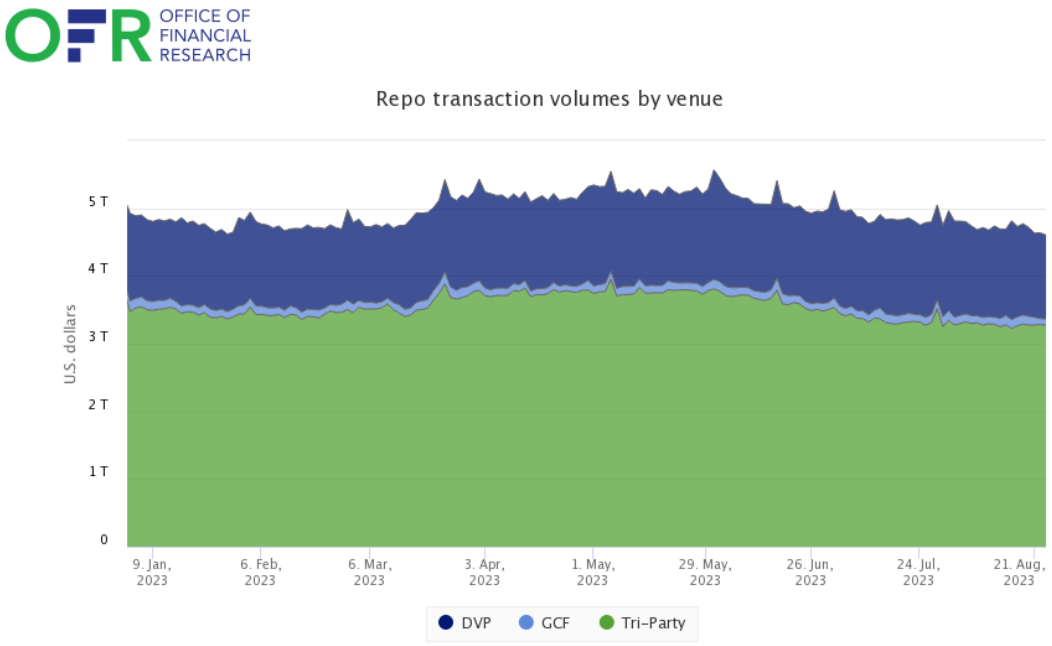
Although FICC's sponsored repo offering continues to gain traction with buy side participants, it still comprises only a fraction of daily volumes for U.S. treasury-linked repurchase transactions, as reflected over the last 5 years in the graph below:[25]



[20] *See* DTCC Annual Report, *available at:* https://www.dtcc.com/about/-/media/Files/Downloads/Annual-Report-2022/DTCC2022AR-PRINT.pdf.
[21] Final Rule at 2717.
[22] *See* DTCC, Sponsored Service, *supra* note 20.
[23] *See* DTCC Sponsored Member Listing, *available at:* https://www.dtcc.com/client-center/ficc-gov-directories.
[24] *See, e.g.*, F.A.Q. FICC – GSD, *available at:* https://www.dtcc.com/ustclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-GSD-FAQ.pdf.
[25] DTCC provides regularly updated data on repo activity, *available at:* https://www.dtcc.com/charts/membership.

The Clearing Rule would subject most of the total repo trading volume to a central clearing regime, which would entail perhaps a doubling of the volume of Repo Transactions cleared via FICC.

For additional context, the graph below illustrates repo volumes over the course of 2023, as compiled by the U.S. Office of Financial Research:[26]



Source: OFR U.S. Repo Markets Data Release

As reflected in this graph, the majority of daily repo trade volumes come from triparty arrangements. Data collected by SIFMA shows that USTs make up over 70% of collateral in triparty repo transactions.[27] The Bank of New York Mellon is the sole triparty repo agent (and is also a sponsoring member of FICC). In 2021, FICC Centrally Cleared Institutional Triparty (CCIT) service was approved and offers central counterparty services to a limited number of Government Securities Division (GSD) dealer members and eligible tri-party money lenders.[28] The Clearing Rule requires FICC (or another covered clearing agency not yet in existence) to drastically expand the current central counterparty services offered for triparty repo.

What documentation is required for the Buy Side to access Repo Clearing?

Under the current FICC sponsored member paradigm, access to the sponsored member repo clearing platform typically requires the buy side end user to agree to an annex or addendum to the bilateral Master Repurchase Agreement with their sponsoring member.[29] This annex governs terms between the sponsored member and sponsoring member relating to the bilateral repo transactions that the sponsoring

[26] United States Office of Financial Research, Market Digests, *available at:* https://www.financialresearch.gov/short-term-funding-monitor/.
[27] *See* SIFMA, *SIFMA Research, The US Repo Markets: A Chart Book* (February 2022), *available at:* https://www.sifma.org/wp-content/uploads/2022/02/SIFMA-Research-U.S.-Repo-Markets-Chart-Book-2022.pdf.
[28] Information about FICC's sponsored tri-party repo clearing service is also available on the DTCC website. *See* DTCC, Sponsored Service, *available at*: https://www.dtcc.com/clearing-services/ficc-gov/sponsored-membership.
[29] Some dealers acting as sponsoring members will supplement this annex with a stand-alone bilateral contract or contracts addressing different aspects of the sponsored member clearing arrangement and the relationship with their customer.

member agrees to novate to FICC for central counterparty services. Because the sponsoring member is guarantying the obligations of the sponsored member to FICC, these terms frequently include credit terms and provisions relating to margin to be provided by the sponsored member to support the cleared repo transactions, as well as provisions relating to indemnification and reimbursement of the sponsoring member for any amounts for which the sponsoring member is liable in connection with the sponsored member's cleared repo transactions. The form of annex and its terms, as well as any supplemental stand-alone agreements, are not standardized or published by an industry group, and are often negotiated. In addition to the bilateral terms agreed between the sponsored member and the sponsoring member, the sponsored member is required to complete a FICC sponsored member application and FICC Sponsored Membership Agreement as part of FICC's onboarding approval process.

UST Repo Clearing – Five Key Issues for the Buy Side

Access to CCAs and development of clearing infrastructure

Given the scope of the Clearing Rule, buy side firms should consider how they will access central clearing services. A threshold concern for all market participants is that FICC is currently the only CCA offering central clearing services for Repo Transactions. This is in contrast to the OTC derivatives clearing space, where a number of central clearing counterparties are available to the market. The existence of a single CCA may entail too great a concentration of risk, as well as a lack of meaningful competition, with foreseeable consequences for pricing (fees) and access.

For example, the FICC sponsored membership model currently requires sponsored members to be qualified institutional buyers, as defined in the Exchange Act. While FICC has noted that its prime broker and correspondent clearing models can be used by end users who do not qualify for the sponsored membership model,[30] these models do not offer the same level of benefits as sponsored membership because the indirect participant does not face FICC directly and is more dependent on the performance of the direct participant intermediary. The fact that smaller end users would be limited to such alternatives shows how FICC rules and infrastructure can serve to limit or channel access in a way that might work against the objects of the Clearing Rule.

Another issue to consider in this respect concerns the treatment of give-up or "done away" transactions. These are transactions executed with an "executing" dealer and then novated, or "given up", to a dealer that would act as a sponsoring member. Similar to the derivatives "prime broker" intermediation model, this arrangement allows the end user to avail itself of a large number of pricing sources for execution, then consolidate its clearing portfolio with just one or a small number of direct participants. FICC rules do not currently require its sponsoring members to accept these "done away" transactions for clearing, and the Commission expressly refused to make such a requirement. Dealers acting as sponsoring members do not generally accept these transactions voluntarily, due to risk management concerns in their capacity as a direct participant guaranteeing performance of their clients. However, FICC has stated that it is taking this issue into consideration and will engage in dialog with industry participants and regulators.[31]

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[30] *See* DTCC, *Looking to the Horizon: Assessing a Potential Expansion of U.S. Treasury Central Clearing* (September 13, 2023) ("**DTCC White Paper**") at 10, *available at:* https://www.dtcc.com/dtcc-connection/articles/2023/september/13/looking-to-the-horizon-assessing-a-potential-expansion-of-us-treasury-central-clearing.

[31] *See Id.* at 11.

Initial margin and cross-margining

Buy side firms should also consider the impact of initial margin requirements imposed by direct participants, as well as the availability of cross-margining, two issues with implications for the costs associated with central clearing. As noted above, under a sponsored membership clearing model, such as FICC's, the direct participant that is the sponsoring member guarantees the performance of its sponsored member to the CCA. Because this arrangement exposes the direct participant to the credit risk of the indirect participant customer, the direct participant will typically require the indirect participant to deliver additional margin ("initial margin") to the direct participant that is in excess of the margin the direct participant is required to deliver to the CCA in respect of the indirect participant's positions. These initial margin requirements are often negotiated as a credit term between the parties, as we see in the cleared OTC derivatives space. But however agreed, any initial margin requirement will likely represent an overall increase in the amount of capital required to maintain the positions as compared to bilateral transactions.

The increase in costs associated with initial margin requirements might be offset or reduced by expanding the availability of cross-margining of customer positions across clearinghouses. FICC is exploring an expansion of its current cross-margining arrangements to encompass asset classes such as swaps.[32] If customer margin could be applied across platforms in connection with a broader set of asset classes, this would create significant efficiencies and likely reduce the overall amount of margin indirect participants would have to provide to support their portfolio of cleared Repo Transactions.

Counterparty and CCA Risk, including Customer Protections

The Clearing Rule relies on the central clearing model to mitigate systemic and counterparty risk. However, clearing does not eliminate all risk. For example, the Clearing Rule does not directly address certain risks associated with the failure or default of a direct participant acting as sponsor or intermediary, or the failure of the CCA itself. Under certain circumstances the failure or default of a sponsoring member could lead to a failure to settle transactions intended to be cleared via that entity, or otherwise allow FICC to unwind those transactions. In the futures clearing model used for clearing of OTC derivatives, transactions cleared via a defaulting member of the CCA can (and are routinely) "ported" (*i.e.*, transferred) to a solvent member, allowing the transaction to continue unaffected. FICC rules do not currently support porting of customer (indirect participant) transactions from a defaulting sponsoring member, as is the case in the derivatives clearing space. However, FICC has noted that it is considering allowing such a process in the interest of increasing confidence among indirect participants.[33] Buy side participants assessing this risk should review the GSD Rules, which set out the procedures available to FICC following the default of a defaulting sponsoring member.[34]

Buy side participants can draw some comfort from the fact that the Clearing Rule requires the segregation of customer (indirect participant) margin from that of dealers (direct participants), as discussed above. This will protect indirect participants from losses resulting from a defaulting direct participant. The Commission noted, however, that it was not requiring that a CCA protect indirect participants from losses resulting from the default of another indirect participant (so-called "fellow customer" risk). Nonetheless,

[32] *See* DTCC White Paper at 17.

[33] *Id.* at 18.

[34] *See* FICC GSD Rules, Rule 22A, *available at:* https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.

FICC has stated that it intends to establish such protections in implementing its account structure under the post-adoption customer protection regime.[35]

In addition, a failure of FICC, as unlikely as that might be, would almost certainly cause major disruptions in the UST market and could potentially lead to recovery shortfalls for participants. The fact that FICC is currently the only CCA offering central clearing services for the UST market presents a significant concentration risk and led several market commenters to ask that the Clearing Rule be delayed until there is at least one additional CCA offering UST clearing services as a backstop to FICC. However, in the Commission's view, this concentration risk is mitigated by the regulatory and supervisory framework governing FICC, including its status as a "systemically important" institution under the Dodd-Frank Act. Additionally, FICC is subject to the Covered Clearing Agency Standards that require CCAs to monitor and manage their credit and liquidity risk. [36]

Dealer/intermediary relationship documentation

Like other regulatory projects of similar scope, the Clearing Rule requires market participants to manage additional paperwork and documentation in order to complete the process of accessing the CCAs. The primary concern in this respect is the lack of standardized documentation to memorialize the terms governing the relationship between indirect and direct participants. As noted above, the direct participant takes credit risk of the indirect participant, and will therefore likely require indemnities, reimbursement rights, liens and other contractual remedies against the indirect participant. Currently, there is no standardized form available to document this relationship, and buy side participants must expend time and money to review and negotiate the different forms provided by each direct participant with whom they contract. FICC has recently stated that it agrees with those participants who have raised this issue, and has offered to work with SIFMA and market participants to develop appropriate standardized documentation.[37]

Implementation: timing and sequencing

The Commission adopted a phased implementation approach. The compliance dates are listed below:

- March 31, 2025: CCAs must implement policies and procedures for risk management, protection of customer assets (which includes holding margin for direct participants' proprietary transactions separate from margin submitted on behalf of indirect participant transactions), and access to clearance and settlement services for indirect participants.

- December 31, 2025: Cash transactions between direct participants who are acting as interdealer brokers and cash transactions between a direct participant and a registered broker-dealer or a government securities dealer or broker must be cleared at the CCA.

- June 30, 2026: All repurchase and reverse repurchase transactions where a direct participant is a counterparty must be cleared at the CCA.[38]

[35] *See* DTCC White Paper at 23.
[36] Final Rule at 2720-2721.
[37] DTCC White Paper at 10.
[38] Final Rule at 2770.

Although the final compliance date to clear repo transactions is slated for summer 2026, timely preparation should be a major concern for every market participant, especially for those on the buy side who will need to complete their assessment of the rules and review and possibly negotiate the documentation necessary to access the CCA(s) and comply with the mandate. This implementation burden cannot be underestimated: asset managers and hedge funds will need to put in place clearing annexes, give-up agreements and other required documentation, address issues concerning investment mandates and guidelines that might require amendment of investment management agreements and disclosure, and consider the implications for allocation processes for block trades and separately managed accounts.

Conclusion

The Clearing Rule represents an extraordinarily expansive regulatory project that will have huge implications for everyone participating in the UST market. Buy side participants will need to assess the implications of the clearing mandate, maintain dialog with dealers who will be the direct participants and intermediaries in the clearing regime, as well as conversations with the major industry associations, the SEC, and FICC and any other (possible future) CCAs. As always Seward & Kissel remains available to answer any questions that arise regarding the impact of and compliance with the Clearing Rue.

Questions?

If you have any additional questions about the Clearing Rule, or any other regulations affecting the derivatives markets, please reach out to any of the members of Seward & Kissel's Derivatives Practice group listed below, or contact your Seward & Kissel attorney.

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transactions, derivatives regulation and compliance and trading relationship documentation (such ISDA Master Agreements and prime brokerage arrangements).

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