What to know about gaining access to U.S. Treasury central clearing

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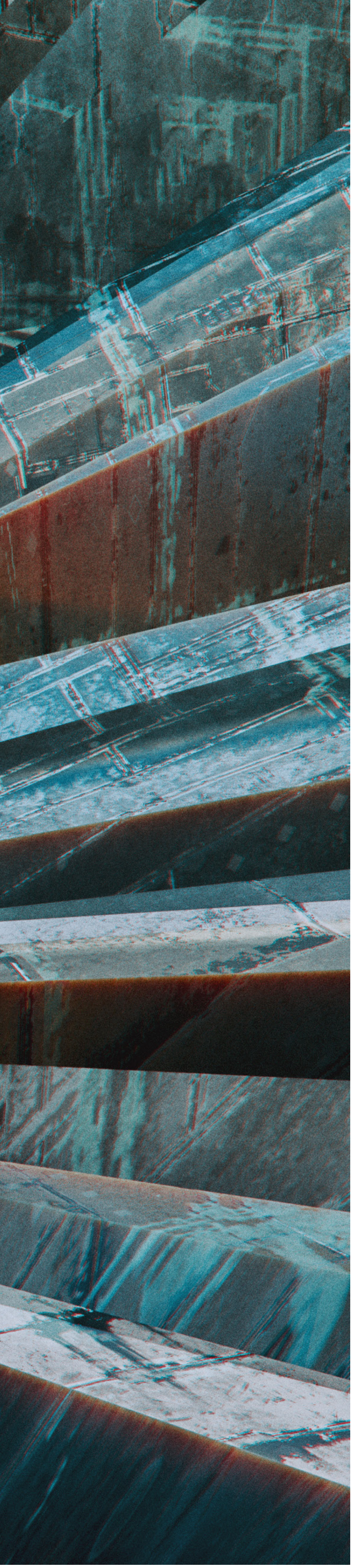
To choose a clearing access model, market participants should consider benefits, limitations, operating frameworks and economics.

- Firms must act quickly to analyze, select and implement a clearing access model before the mandate goes into effect.
- Each clearing access model has benefits and limitations as well as different eligibility criteria, application processes, and compliance requirements.



By expanding the scope of which transactions must be cleared through the adoption of the U.S. Treasury central clearing mandate, the Securities and Exchange Commission introduced a far-reaching change that will have a profound impact on financial market participants.

Complying with the mandate requires a complex set of decisions for market participants who must analyze, select and implement a clearing access model to continue trading without disruption, all of which must be done in a timely manner – Treasury central clearing is required to go into effect by December 31, 2025, and repo central clearing is required to go into effect by June 30, 2026.

The model a firm chooses will significantly impact the economics of their business and regulatory requirements.

Fixed Income Clearing Corporation (FICC) offers a variety of access models to both buy-side and sell-side market participants. To select the most appropriate model, firms will need to consider the benefits and limitations of each relative to their business strategy and current operations. While FICC is the only covered clearing agency as of October 2024, firms also should be prepared to adapt their clearing strategy if additional central clearing agencies enter the market.

Access models fall into two categories:

Direct participant
These institutions are members of FICC, which allows them to directly access FICC's clearing and settlement services. Direct participants encompass a wide range of entities, including dealers, inter-dealer brokers, registered investment companies, government securities issuers, banks, foreign entities, registered clearing agencies, and buy-side firms.

Indirect participant
These institutions do not have full or direct membership with FICC and instead rely on arrangements with direct participants to gain access to FICC's central clearing and settlement services. Indirect participants typically choose to forego direct membership due to the complexity of requirements or because it is uneconomical to pursue for their given situation.

Once a decision has been made between direct and indirect membership, firms must assess which clearing access model will best align with their strategic objectives and operational capabilities. Some factors to consider are transaction volume, capital and operational requirements, risk management capabilities, and desired level of involvement in the clearing process.

Direct participants clearing access models include are as follows:

Netting membership
Netting members can self-clear trades through FICC for proprietary positions and have access to FICC netting and settlement services that provide centralized, automated clearance and guaranteed settlement of eligible U.S. Treasury securities. Through this service, FICC establishes a single net long or short position for each participant's daily trading activity in each security. Netting membership may be more suitable for large institutions that engage in a high volume of transactions and seek to benefit from FICC risk management services and multilateral netting, which helps reduce settlement volumes and exposures. Additionally, being a full netting member grants the right to offer agent clearing to clients.

Centrally Cleared Institutional Triparty (CCIT) membership
The CCIT service is a limited Government Securities Division (GSD) membership for tri-party cash lenders with at least $100m in net assets. This membership type expands on FICC's General Collateral Financing Repo service to extend services and settlement guarantee to tri-party repo transactions between GSD dealer members and eligible tri-party cash lenders. While there are outstanding industry questions regarding the scope of tri-party repo clearing under the new mandate, clearing this activity reduces counterparty risk by guaranteeing the completion of settlement in a member default scenario. The central counterparty guarantee and ability to centrally liquidate a failed counterparty are designed to mitigate risks and market disruption.

Sponsoring membership
Sponsoring members provide clients with access to central clearing services by acting as the processing agent and assuming certain responsibilities, such as guaranteeing sponsored members' obligations, posting margin to FICC, and submitting trades to FICC. The sponsored service program grants similar benefits to market participants who may not be eligible for netting membership or who elect not to be a direct member. This includes Treasury repo and cash market access, centralized risk management, default management, and netting. Sponsoring membership may present commercial opportunities for firms such as through the acquisition of new clients or the need to serve existing clients.

Agent clearing membership
Agent clearing members enable their customers to execute trades with multiple counterparties and direct those transactions to a clearing member for clearing and settlement. Under this model, participants may charge executing firm customers fees in return for access to the treasury and repo market, bundling in additional services such as reporting, risk monitoring, reconciliations, and tri-party repo. In return for these fees, the agent clearing members assume the liability for all client transactions, processing and risk management. FICC has no direct relationship with the agent clearing member's executing firm customers. This is the only FICC model that allows for netting across clients, which could substantially lower margin requirements.

Indirect participants clearing models include:

Sponsored membership
These are firms that are not direct members of FICC but access clearing services through a sponsoring member, who facilitates their transactions and provides necessary clearing support such as margin posting. Sponsored members rely on sponsors to navigate the central clearing process and work with them to manage the operational and financial requirements of central clearing. These firms gain access to central clearing benefits without having to fulfil all the requirements of a netting member. While sponsored members are principally liable to FICC for their trade and funds only settlement obligations, the sponsor guarantees obligations making them liable in the event the sponsored member cannot satisfy their obligations.

Agent clearing executing firm customer
Under the agent clearing service, indirect participants (referred to as an "executing firm customer") can execute trades with a third-party FICC participant. The agent clearer then clears the trades at FICC. Since they are not members of FICC, executing firm customers do not have any liability or obligation to FICC. Instead, the agent clearer assumes these obligations. Executing firm customers are often hedge funds, asset managers, or other similar buy-side entities. They may be charged fees by their agent clearer for access to the treasury and repo market and to receive other service benefits, including reporting, risk monitoring, reconciliations and tri-party repo.

Each clearing access model comes with its own eligibility criteria, application processes, compliance requirements, risks and recourses. Firms should undertake a cost analysis to determine the most suitable approach to access U.S. Treasury and repo markets. When onboarding, firms also should assess their operational integration with FICC systems and be prepared to maintain ongoing monitoring and adherence to regulatory requirements. With the sponsoring and agent clearing membership models, firms can elect to have segregated client omnibus accounts, a non-segregated client omnibus account, or both. Segregated accounts enable firms to collect client margin, post onward to FICC and benefit from a 15c3-3 debit. Additionally, both models provide the ability for indirect members to execute trades with its sponsoring/agent clearing member ("done-with") or with a third-party GSD netting member ("done-away"). Firms will need to consider all access model permutations when determining their clearing strategy.

Though firms must implement a clearing access model prior to the deadlines, it is important to note that market participants are not making a permanent business decision. As business needs, trading strategies, and risk management capabilities evolve, a firm may find another clearing model more suitable. While transitioning between models may require careful planning and coordination with FICC, firms can choose to change memberships or offer different clearing services in the future. Taking an adaptable approach as business needs evolve will be the key to navigating the U.S. Treasury central clearing mandate.

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