

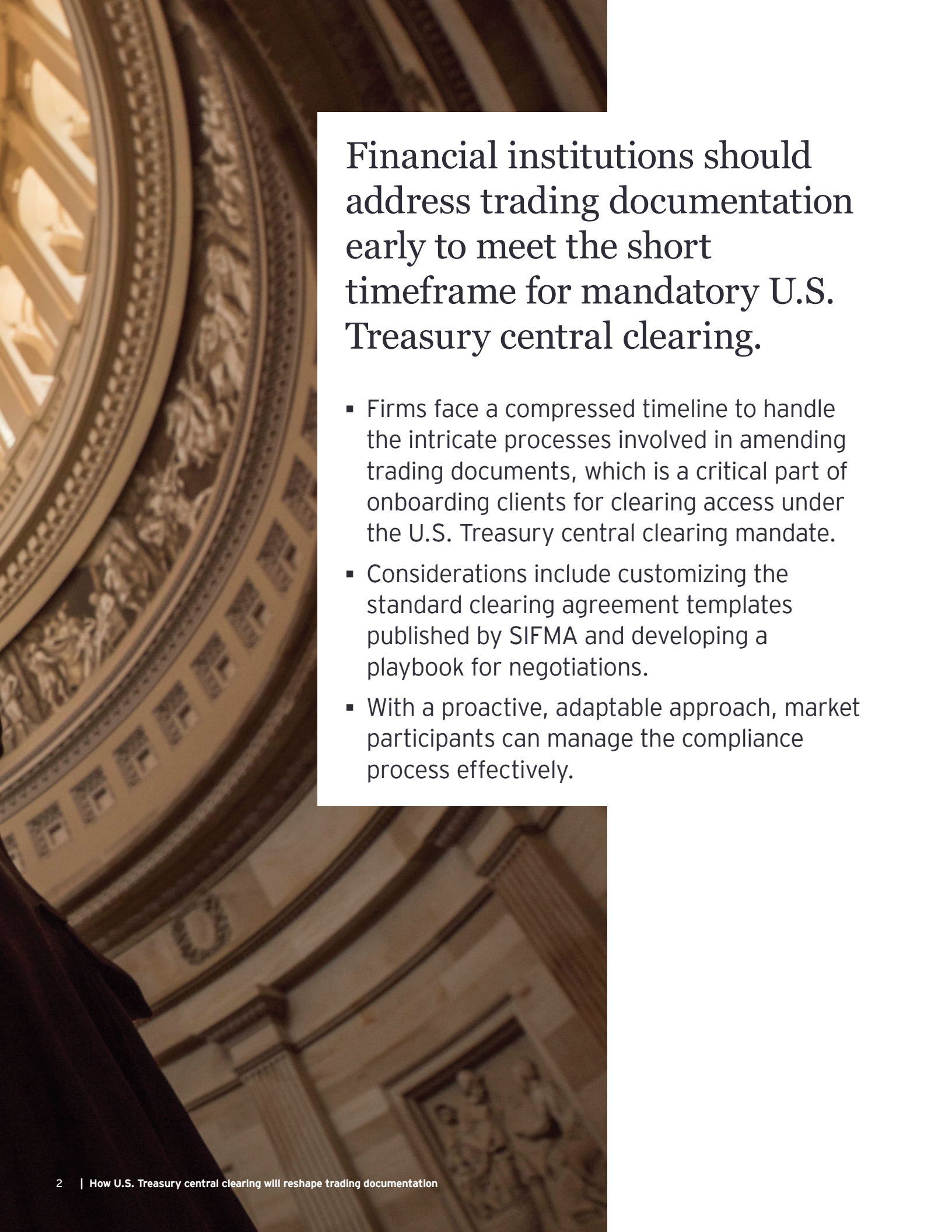


How U.S. Treasury central clearing will reshape trading documentation

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Financial institutions should address trading documentation early to meet the short timeframe for mandatory U.S. Treasury central clearing.

- Firms face a compressed timeline to handle the intricate processes involved in amending trading documents, which is a critical part of onboarding clients for clearing access under the U.S. Treasury central clearing mandate.
- Considerations include customizing the standard clearing agreement templates published by SIFMA and developing a playbook for negotiations.
- With a proactive, adaptable approach, market participants can manage the compliance process effectively.

Seeking to enhance market transparency and reduce systemic risk, the Securities and Exchange Commission's central clearing mandate for the U.S. Treasury and repo markets will usher in significant regulatory and market structure changes. Among the many challenges ahead, the complexities associated with trading documentation are substantial. To comply, market participants will need to implement a robust contracting and onboarding process. Client profiling related to the access model will be required. Firms also will need to tailor templates to reflect their operational and risk needs, as well as to the various client profiles and needs.

Early preparation will be critical under the compressed compliance timeline, which requires that U.S. Treasury transactions be cleared through a covered clearing agency (CCA) by December 31, 2025, for certain cash purchases and sales; and by June 30, 2026, for repos. **Utilizing the roadmap in the three phases below will help confirm compliance by the deadline:**

- 1. Client profiling and communication**
- 2. Legal artifact creation**
- 3. Negotiation**





01 Client profiling and communication

The complexity of contracting and onboarding stems from the variation of documentation across different client profiles. Each profile may have unique regulatory, jurisdictional and operational (e.g., netting and accounting) considerations. The chosen market access model also will require documentation tailored to the client. Participants will need to be mindful of the initial decisions that are made to comply with the rule. The interconnection of the areas mentioned above will impact the type and volume of documentation that will be required.

Client profiling should include:

- Reviewing U.S. Treasury cash and repo data to determine trading activity subject to the mandate
- Classifying clients by biographical profile (e.g., trading volumes, jurisdiction, credit risk)
- Identifying accounts (e.g., 40 Act funds, corporates) that will enter the cleared U.S. Treasury market and engaging with those clients to discuss the implications
- Determining potential market access models for each client profile

A plan should be established for executing client communications and education initiatives that clearly explain market structure changes and prepare clients for the shifts ahead. Additionally, there will potentially be new entrants into the clearing space besides Fixed Income Clearing Corporation (FICC) that intend to offer centralized clearing. At the outset, market participants will need to understand the various contingencies to completing their suite of documentation, including existing and new market access models, decisions on existing clearing documentation, as well as the expected contracting timelines for the updated suite of trading agreements.

Implementing onboarding and support processes for a smooth transition also is critical in this first phase. Onboarding activities should include:

- Gathering impacted documents based on client profiles to set up clearing relationships
- Collaborating with legal teams to make the required enhancements to new and existing templates
- Determining a tracking methodology for onboarding and operational setup
- Selecting technology enablers for the management and tracking of clearing application submissions
- Implementing a process to ensure all necessary activities to establish cleared relationships are completed

Completion of this first phase will inform legal teams on how to approach legal artifact creation and negotiation in the ensuing stages.

02 Legal artifact creation

Though the Securities Industry and Financial Markets Association (SIFMA) has released a standard clearing agreement template, financial institutions should view this as a foundational framework with a two-step customization process. First, firms should tailor the templates to their own operational and risk needs. Then firms may need to create variations based on client profiles. Additionally, many market participants already use the clearing services provided by FICC and have documentation in place. This documentation facilitates their relationship with FICC and with the sponsoring member, who acts as the processing agent and provides clients with access to central clearing services. This documentation may need to be amended or recreated based on the offering of new access models and clearing houses.

Additional guidance and negotiation artifacts may need to be created for the different profiles. These include:

- Applicability matrices
- Drafting and negotiation playbooks with preferred terms and fallbacks
- Escalation matrices
- Guidance on ERISA, tax, jurisdictional analysis, representations and warranties, and other considerations.

As the market matures, firms also should prepare for the continuous evolution of documentation standards and artifacts. Historically, templates and enablement artifacts evolve over a period of years in reaction to evolving markets, regulatory changes and specific client scenarios. However, the U.S. Treasury central clearing compliance deadline significantly compresses this timeframe into a matter of months.





03 Negotiation

Firms will face a balancing act as they seek to create a template with their preferred language that anticipates friction points with clients and aims to reduce the amount of negotiation required. As new clearing houses potentially enter the arena, decisions will also have to be made regarding such things as cross product margining and additional or amended documents for existing clearing participants. While it's impossible to predict which provisions will become potential areas for negotiation friction, we believe the provisions below will likely require increased attention by negotiators:

- Cross-default
- Cure periods
- Set-off and cross set-off
- Mini closeout
- Limitation of liability
- Collateral, rehypothecation and security interest
- Representations, warranties and covenants

The following steps can help empower negotiators and facilitate the amendment negotiation process:

- Creating robust playbooks with fallback clauses that can be used with or without further approvals
- Giving flexibility to negotiators through approval matrices and escalation procedures for nonstandard terms
- Having an operational mechanism during negotiations to deal with the deviation approval requests across business, credit, risk, collateral and legal
- Running workshops to educate negotiators on the fundamentals and implications of the SEC rule, the document suite, and the interaction with legacy documents
- Understanding that some clauses that are preferable may be deal-breakers for other institutions

As the industry braces for these transformations, financial institutions will need to adopt a forward-thinking, flexible approach that focuses on contracting and onboarding. While the goal of the central clearing mandate for the U.S. Treasury and repo markets is to enhance market transparency and reduce systemic risk, the challenges associated with implementing access models, legal documentation and resourcing are substantial. By developing a program that can adapt to anticipated industry changes while managing a wide range of impacts, firms can effectively navigate the new regulatory environment.

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