April 30, 2025

Via Electronic Mail: tmpg@ny.frb.org

TMPG Secretariat
Chair Casey Spezzano
Treasury Markets
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Re: TMPG Consultative White Paper on NCCBRs and Indirect Clearing in U.S. Treasury Market and Best Practices

Dear Chair Spezzano:

MFA[1] appreciates the opportunity to comment on the Treasury Market Practices Group's ("**TMPG**") consultative white paper on margin practices for non-centrally cleared bilateral repos ("**NCCBRs**") and indirect clearing in the U.S. Treasury market ("**White Paper**"),[2] updates to best practices for Treasury, agency debt, and agency mortgage-back securities markets ("**Proposed Best Practices**"),[3] and proposed frequently asked questions (FAQs) regarding Treasury repo risk management ("**Proposed FAQs**").[4]

Given the critical role that the U.S. Treasury markets play in the U.S. and global economies, we support efforts to enhance Treasury market efficiency and resiliency by modernizing market infrastructure to account for the significant growth of U.S. debt. However, while we back the TMPG's goal to improve the

1 Managed Funds Association (MFA), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

2 TMPG, Consultative White Paper on Centrally Cleared Bilateral Repo and Indirect Clearing in U.S. Treasury Market: Focus on Margining Practices (Feb. 26, 2025), available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG-Consultative-White-Paper.pdf.

3 TMPG, Proposed Updates to Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets (Feb. 26, 2025), available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG-Proposed-Best-Practices-on-Treasury-Repo-Risk-Management.pdf.

4 TMPG, Proposed Frequently Asked Questions (FAQs): Treasury Repurchase Agreement Risk Management (Feb. 26, 2025), available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG-Treasury-Repurchase-Agreement-Risk-Management-Recommendation-FAQs.pdf.

resiliency of the U.S. Treasury markets, we question the timing of the White Paper in light of the forthcoming transition to central clearing. The transition to central clearing will fundamentally change the repo market, and it is unclear how much uncleared repo activity will continue after the mandate goes into effect. We recommend the TMPG wait to propose changes to the Best Practices until the effects of the clearing mandate are clear. This is particularly important because the transformation of the market to central clearing requires that members spend significant time and attention to preparing for the legal and operational risks of that future state[5] without simultaneously shifting the current state and exacerbating those risks.

Moreover, we question whether it is internally consistent for the TMPG to change the Best Practices now, given that the TMPG believes that certain segments of the U.S. Treasury market lack transparency. Recommending changes to market practices with admittedly insufficient information about and understanding of the NCCBR market seems rushed and ill-advised. The U.S. Treasury Department's Office of Financial Research ("**OFR**") has begun collecting information from broker-dealers and government securities broker-dealers regarding NCCBRs. At a minimum, the TMPG should allow time for OFR to collect data on NCCBRs and then further analyze these data—including how they change after central clearing—before introducing changes to the Best Practices for margin.

If the TMPG decides to proceed, despite the changes underway already, we have serious concerns about the recommendations themselves. The White Paper could be read to insufficiently acknowledge firms' need for flexibility in applying proportionate, risk-based margining to their repo transactions. The TMPG should state clearly that establishing haircuts (or margining) is a commercial decision based on a variety of factors; if no haircut is applied in a particular transaction, it does not follow that appropriate risk management of the position is absent. While the Proposed Best Practices do recognize that prudent haircuts (or margin) should be "in concert with other risk management techniques," the TMPG should make it clear that it is not calling for mandatory minimum haircuts. Haircuts (and margin) are only oneway that a firm may risk manage its repo transactions.

Below we discuss each of the Proposed Best Practices and, as applicable, Proposed FAQs in more detail.

Proposed Best Practices and FAQs

As an initial matter, the TMPG should make it explicit that the Proposed Best Practices only apply to NCCBRs, not to centrally cleared repos or indirectly centrally cleared ("**sponsored**") repos. Netting members of the Fixed Income Clearing Corporation ("**FICC**"), the only clearing house that currently centrally clears U.S. Treasury repos, are already subject to extensive risk management and documentation

5 To give firms more time to prepare for central clearing, the SEC recently extended the compliance dates for the Treasury Clearing Rule. *See* Extension of Compliance Dates for 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, 90 Fed. Reg. 11134 (Mar. 4, 2025), available at: https://www.govinfo.gov/content/pkg/FR-2025-03-04/pdf/2025-03351.pdf.

requirements established by FICC.[6] For example, netting members must post initial and variation margin with FICC for their sponsored repo trades. Whether netting members decide, in turn, to collect margin payments from any particular client (and the amount of margin) involves risk management and creditworthiness considerations as well as the firm's commercial goals; the same considerations a firm would evaluate when deciding to sponsor a client for central clearing.[7]

Proposed Best Practice #1

> *Consistent with appropriate risk management of counterparty exposures, all Treasury repurchase agreements (repo) should include prudent haircuts (or margin) on the value of the securities, in concert with other risk management techniques. The haircut should reflect the counterparty credit risk, as well as the liquidity and market risks of the collateral. The haircut can be applied together with other risk management tools, such as position limits, netting agreements, and/or portfolio margining, when supported by a robust risk management framework and a complete set of legally enforceable written agreements.*

Firms should have the flexibility to apply proportionate, risk-based margining to their NCCBRs. Establishing haircuts (or margining) is a risk-management decision and affects the credit exposure of both counterparties. The lack of a haircut in a particular transaction does not imply the position is not effectively risk managed. While the Proposed Best Practice #1 does recognize that prudent haircuts (or margin) should be "in concert with other risk management techniques," the TMPG should make it clear that it is not calling for mandatory minimum haircuts. Haircuts (and margin) are only one of several ways that a firm can manage the risk of its repo transactions.

As a recent publication by the Federal Reserve recognized, repo transactions are often part of a portfolio margining or cross-margining arrangement, where the margin collected on other positions mitigates the risk of the positions.[8] For example, a fund may enter into a cleared treasury futures position. In connection with this transaction, a Futures Commission Merchant ("**FCM**") will collect margin consistent with clearinghouse requirements. Simultaneously, the fund may enter a repo transaction to finance the deliverable treasury securities with the same FCM. Doing so not only reduces potential risks to the counterparty and the financial system but also allows for more accurate and efficient margining. By contrast, requiring haircuts on all repo transactions on a standalone basis would ignore risk-reducing offsetting transactions and determinations of counterparty creditworthiness, deviate from longstanding market practices, and impair market liquidity. As the Federal Reserve publication acknowledged, "[I]n many

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6 *See* https://www.dtcc.com/~/media/files/downloads/legal/rules/ficc_gov_rules.pdf.

7 A discussion of the implications of requiring haircuts (or margin) on cleared/sponsored trades is beyond the scope of this comment letter.

8 R. Jay Kahn & Matthew McCormick, "Proportionate margining for repo transactions," FEDS Notes (Feb. 14, 2025) available at: https://www.federalreserve.gov/econres/notes/feds-notes/proportionate-margining-for-repo-transactions-20250214.html.

cases minimum haircuts would not lead to proportionate margining, and therefore could decrease liquidity in repo and securities markets without offering a substantial increase in protection."[9]

For these reasons, it is imperative for the TMPG to explicitly state that haircuts (or margin) are not mandated by the Proposed Best Practices and that what is prudent in terms of haircuts and margining depends on the facts and circumstances of the NCCBR transactions. Furthermore, we believe the Proposed Best Practices should only apply to NCCBRs. To the extent the TMPG extends the application of the Best Practices to centrally cleared Treasury repos, it should state that whether a dealer posts its own capital to margin positions with FICC (or other such central clearing agency) or posts customer margin is a commercial decision. This decision is heavily influenced by the creditworthiness of the dealer's counterparty in the transaction because the dealer is liable to FICC as the guarantor of a sponsored trade.

Proposed Best Practice #2

> *Legal agreements should describe, in all material respects, the margining regime, including timing, frequency, and thresholds of margin calls and exchanges; valuation of exposures and collateral; and close out netting and liquidation in case of counterparty default. (Please refer to the proposed FAQs: Treasury Repurchase Agreement Risk Management for detailed best practice guidance.)*

We do not believe that the TMPG should adopt Proposed Best Practice #2 regarding legal agreements. Extensive, industry-standard documentation already exists, and each repo transaction is typically confirmed using industry-standard confirmation statement templates, including the practice of "deemed" documentation to preserve the dealer's rights if a customer defaults.[10] Imposing additional prescriptive requirements in all legal agreements may be impractical. Legal documentation is a question of prudent risk management and appropriate capital treatment of the transaction.

Proposed Best Practice #3

> *For trades with maturities longer than overnight, to help both parties mitigate counterparty risk owing to market value changes, variation margin should be exchanged by the counterparties to the transaction on a regular basis.*

As in the case of Proposed Best Practice #1, firms should have the flexibility to apply proportionate, risk-based margining to their NCCBRs. Whether to request margining is an operational and risk management decision and depends on many factors. The fact that margin is not collected in a particular case does not mean that the position is not effectively risk managed. Similar to Proposed Best Practice #1

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[9] *Id.*

[10] *See*, *e.g.*, Master Repurchase Agreement and Credit Support Annex of International Swaps and Derivatives Association (ISDA), available at: https://www.isda.org and https://www.isda.org/a/wVrTE/Collaboration-and-Standardization-in-Derivatives-and-SFT-Markets.pdf (explaining framework at 2022 updates to template documentation); Global Master Repurchase Agreement, available at: https://www.icmagroup.org/market-practice-and-regulatory-policy/repo-and-collateral-markets/legal-documentation/global-master-repurchase-agreement-gmra/.

with respect to haircuts, variation margin is a practice that should be pursued "in concert with other risk management techniques." In some cases, it may not be prudent to collect variation margin as it may lead to over-collateralization given other positions the counterparty has with the dealer. In other cases, margin may be requested by a party when an asset's value falls below a set level. Or the parties may agree for operational reasons to close an NCCBR and reopen a new one with an updated cash price instead of collecting margin.

Proposed Revised Best Practice Recommendations Around Risk Management (new text underlined)

> *Risk Management 1. Market participants should apply appropriate risk management rigor to the clearing and settlement of all trading activity. Neither the high credit quality of an underlying instrument nor the short length of the settlement cycle should diminish the attention paid to clearing and settlement processes and risks. Risks to clearance and settlement in covered markets can manifest themselves in a number of ways, including counterparty credit concerns and liquidity needed to cope with operational issues or processes. In their risk management framework, participants should contemplate both gross and net exposures in the clearance and settlement chain because contingency events, including counterparty default, can potentially result in unintended liquidity or credit exposure to gross trading volumes.* <u>*In addition, market participants facilitating central clearing for clients should ensure that all aspects of that activity are well risk managed, including any risks that the client may pose to the participant facilitating central clearing.*</u>

As noted above, the TMPG should make it explicit that the Best Practices only apply to NCCBRs, not to centrally cleared repos. As noted earlier, dealers who are netting members of FICC are already subject to extensive risk management and documentation requirements established by FICC and are guarantors to FICC of sponsored repo trades for clients. Accordingly, we recommend that the TMPG delete the new sentence. It is unnecessary in light of existing requirements.

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MFA appreciates your consideration of our comments. We look forward to working with the TMPG to improve the efficiency and resiliency of the U.S. Treasury markets. We would be pleased to discuss our comments in further detail. Please do not hesitate to reach out to me.

Sincerely,

/s/ Jennifer W. Han

Jennifer W. Han
Chief Legal Officer & Head of Global Regulatory Affairs
MFA