Preparing for the US Treasury Central Clearing Mandate

January 2025

SEC Central Clearing mandate for UST transactions

On Dec 13, 2023 the US Securities and Exchange Commission (SEC) announced expanded clearing requirements for US Treasury (UST) cash and repo transactions that will be implemented in 2025 and 2026, respectively. We expect these enhanced clearing requirements to have significant implications for market participants that trade US Treasuries.

What is it?

To reduce systemic risk, the SEC wants a significantly larger portion of US Treasury cash and repo activity to be centrally cleared through an SEC-designated Covered Clearing Agency (CCA). The Fixed Income Clearing Corporation (FICC) serves as the only CCA for repo transactions in the US Treasury market.

Requirement

The CCAs must have policies and procedures in place to require that their direct members1 clear UST cash and UST repo transactions to which they are a counterparty of.

The SEC wants a significantly larger portion of US Treasury cash and repo activity to be centrally cleared through an SEC-designated Covered Clearing Agency (CCA).

1. Exceptions:

- Repo transactions between a firm and its affiliates
- Certain sovereign entities (e.g., state/local governments, central banks, international financial institutions) are not in scope

Implications

If you are trading OTC bilaterally with direct members today for UST cash or repo trades:

You will no longer be able to trade with these direct members on an uncleared bilateral basis in the future

If you are trading OTC bilaterally with indirect members today for UST cash or repo trades:

You can still trade with these counterparties on an uncleared bilateral basis in the future, **BUT**

Counterparty optionality

- Most major banks/brokers are already direct members today
- Many larger market participants are trending towards direct membership as a result of this mandate

OTC liquidity

- Material reduction on liquidity in the OTC repo market is expected as market moves towards central clearing

OTC funding cost

- Expect widening OTC spreads and increase cost of funding as a result of lowering broker optionality and liquidity

SEC central clearing mandate timeline

Announcement

December 13, 2023

SEC's first announcement of the UST Central Clearing Mandate

UST cash trades

December 31, 2025

Mandatory implementation date for eligible UST cash trades to be cleared

UST repo trades

June 30, 2026

Mandatory implementation date for UST eligible repo trades to be cleared

FICC access models

	Models	Description	Key considerations / Things to know
Direct access	**1. Direct member**	Full FICC Government Securities Division membership.	• Strict eligibility requirements (i.e. Entity type/capital) • Manage own Clearing Fund • Subject to loss mutualization **Operational requirements:** • System connectivity setup • Reporting obligations • Operational testing participation
Indirect access	**2. Sponsored member**	Current standard for FICC indirect access, used by vast majority of indirect participants. Sponsored members (clients) have a contractual relationship with thesponsoring direct member and FICC; trades novate to FICC.	• No entity type/capital requirements • Sponsor posts Clearing Fund on behalf of client • Leverage State Street's capabilities to fulfill the reporting, system connectivity, and operational requirements

Repo transaction volume

Year	Total traded amount ($, Billion)*
2025	$1,932
2024	$1,114
2023	$567
2022	$353
2021	$357

Upcoming in 2025

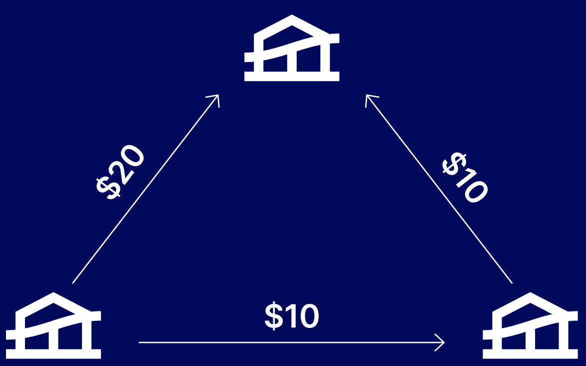
3. Agented clearing

Nascent and expected to be updated by FICC later in the year. We will further update you on this model once the details have been finalized by FICC.

***Source:** DTCC, trade amount represent total of repo and reverse repo activities on the first business day of each year

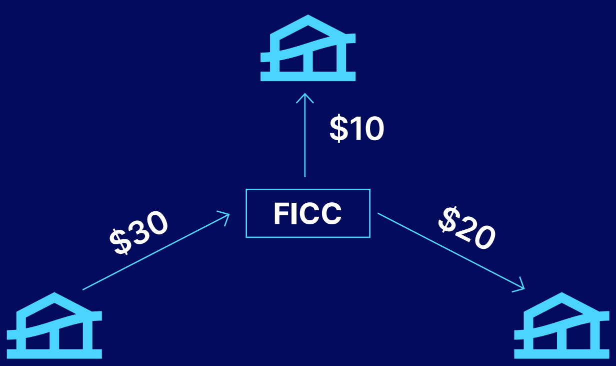
Other than the regulatory requirement, why clear transactions?

Bilateral (with netting)



Due to the interconnectedness of the markets, if one party defaults, many other parties will be impacted due to non-performance of the trading obligations.

Central clearing



A Covered Central Agency (such as FICC) acts as a counterparty to all parties, netting down payment obligations across all the cleared contracts to one payment obligation per party, thus shielding non-defaulting market participants in the event of default.

Key benefits of central clearing with FICC

Counterparty strength

- FICC credit ratings as AA/A-1+ (S&P) and Aaa/P-1 (Moody's)[2]
- Specializing in the matching, clearing and netting of transactions in U.S. Treasuries and Agency debt securities

Capacity and liquidity

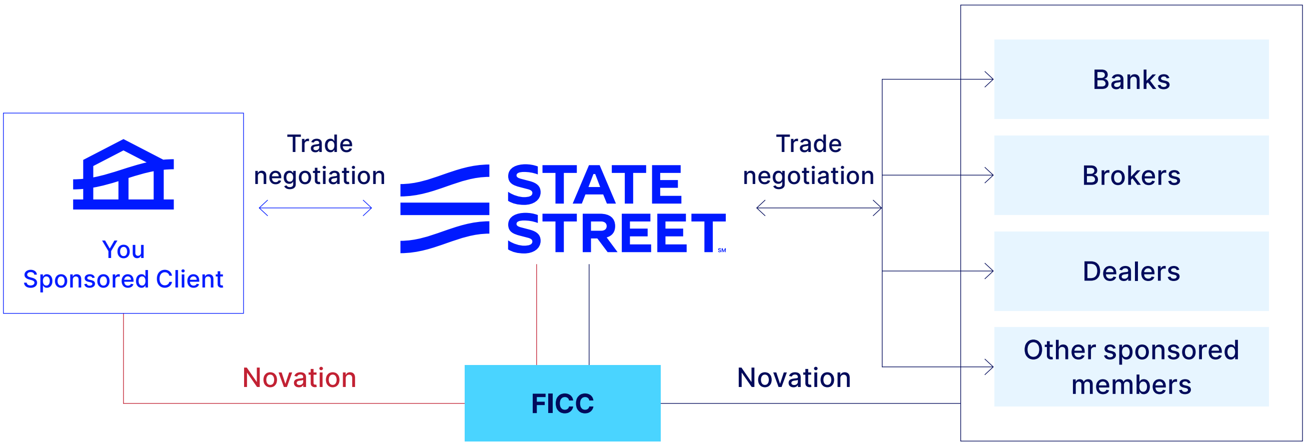
- Access to highly liquid investments
- Facilitating members' ability to maximize the availability of balance sheet netting

Risk mitigation

- Reduced counterparty credit risk weight under BASEL III
- FICC guarantees settlement for all matched trades
- Margin (Clearing Fund) posted by direct members on behalf of sponsored client
- Total daily settlement obligations of participants are greatly lowered as a result of netting

Why choose State Street's sponsored member program?

State Street collaborated with FICC in 2005 to establish the first sponsored cleared repo offering and has maintained a market-leading position to date.



Our value proposition

Streamlined access model

Unlock the benefits of clearing without needing to satisfy full membership obligations. Clients execute limited standardized documentation to trade with State Street, who submits trades to FICC for clearing and handles clearing fund on the clients' behalf.

Liquid financing and investment outlet

Clients invest or borrow cash against US Treasury or Agency securities at flexible terms to achieve incremental gain or generate funding to support broader strategies.

Risk management and credit intermediation

Transactions are collateralized with minimum haircut requirements;
State Street guarantees clients' performance to FICC and is backed by balance sheet of market-leading custodian.
Trades novate to FICC, meaning clients' ultimate exposure is to FICC, a highly-rated central counterparty.

Operational efficiency

State Street manages custodial, infrastructure, and trade processing activity with FICC and integrates directly with the clients' State Street custody, or third-party, accounts.

Frequently asked questions

1. Why is the SEC implementing these changes?

Today, a significant portion of treasury funding and cash markets remains uncleared. A shift to central clearing is intended to reduce contagion risk posed by non-centrally cleared trades in event of default.

2. Is there a possibility that the implementation date of mandatory clearing requirements can be postponed?

While there is a possibility, there has been significant momentum and investment of time / energy by market participants and infrastructure to prepare for the mandate.

3. If we (or our trading counterparties) are not a US entity, do we still need to adhere to these rules?

The rules apply to all direct members of the FICC, even to non-US entities.

4. Do we need to have a custody account at State Street to participate in their Sponsored Member Repo (SMR) Program?

No. A custody account at State Street is not required.

5. Are there any additional costs/fees to participate in State Street's SMR Program?

No. The quotes provided from State Street on repo/reverse repo are inclusive of all costs.

6. Does State Street's SMR program support term transactions?

Yes.

7. I operate mainly in Asian office hours. Do I need a US trading desk to transact in UST repos?

No. State Street offers UST repo trade execution and client servicing within Asian and US trading hours.

8. How long does it take to sign up and be onboarded?

This depends on several factors (e.g. client commitment, the quantity of contested points). Generally speaking, if the client accepts our standard form, onboarding and setup typically takes 1 to 2 months.

9. Should we get multiple sponsoring agents?

Just as there are pros and cons to appointing multiple brokers, using multiple sponsors has benefits as well as additional costs and complications.

For smaller counterparties, the structural challenges of adding a second or third sponsor can be prohibitive. Many prefer the ease of staying with a single sponsor relationship.

However, as liquidity is expected to pivot from uncleared to cleared trade activity, using multiple sponsors may not be a luxury limited to large counterparties, and it may become a necessity for all counterparties.

Appendix

Bilateral vs sponsored centrally clearing with FICC

	Uncleared bilateral repo	State Street FICC sponsored member repo
Venue	Portal, Bloomberg, Phone	Portal, Bloomberg, Phone
Action	Cash Investment or Financing	Cash Investment or Financing
Liquidity	Subject to individual broker capacity	Broad, centralized market-making availability
Rates	Negotiated directly with broker	Stable, competitive
Trade processing/ Custodial services	Managed by client	Handled by State Street
Credit quality	Broker's credit	Fixed Income Clearing Corporation (S&P Credit Rating of AA)
Resiliency	Subject to individual broker's risk management practices	• FICC and State Street guarantee of client's transactions • State Street contributes to clearing fund on client's behalf
Compliant with SEC clearing mandate	No[3]	Yes

3. For transactions in eligible US Treasury securities where at least one counterparty is a FICC Direct Member.

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