



THE EVOLVING STRUCTURE OF THE U.S. TREASURY MARKET: SECOND ANNUAL CONFERENCE

OVERVIEW

For questions on the note below, please contact [Daniel Austin](#) or [Graham Harper](#) at (202) 547-3035.

Today, the U.S. Department of the Treasury (Treasury), the Board of Governors of the Federal Reserve System (Fed), the Federal Reserve Bank of New York (NY Fed), the U.S. Securities and Exchange Commission (SEC), and the U.S. Commodity Futures Trading Commission (CFTC), altogether the “Joint Member Agencies,” held their second annual conference to discuss and better understand the key factors underlying the evolution of the Treasury market's current structure and liquidity. This year's conference was an opportunity to take stock of the progress made by the Joint Member Agencies, including advances related to transaction data reporting and various rules and regulations.

Key Takeaways

- Antonio Weiss, Counselor to the Secretary of the U.S. Department of the Treasury, said that Treasury strongly supports registration of all principal trading firms (PTFs) that are active in Treasury markets, and he referenced both the CFTC (through Reg AT) and the SEC's efforts in this regard. He also expressed support for the registration of electronic trading platforms as ATs under the SEC's purview as well as support for a public post-trade reporting regime with appropriate safeguards to prevent against liquidity disruptions (including possible notional caps/buckets, time delays, and a phase-in).
- CFTC Chair Tim Massad provided a comparison on the October 2014 flash crash in the U.S. Treasury market and the recent flash event in the British pound, which he said underscores the importance of having sufficient market data.
- SEC Chair Mary Jo White discussed recent FINRA rules that would subject all broker-dealers registered with the SEC, that are also members of FINRA, to new reporting rules for U.S. Treasury transactions.
- Chair White also said she has asked SEC staff to consider further clarification on how the conduct of PTFs may trigger dealer registration requirements, whether that conduct is in the U.S. Treasury or equity securities markets.

SUMMARY

Introductory Remarks

[William Dudley, President and CEO, Federal Reserve Bank of New York](#)

Continued engagement between the official sector and the public on Treasury market issues remains necessary to help to manage its evolution, functionality, and integrity. We have been working together to share information and help shape the most effective path forward for public policy. Given the role of the Treasury market as the deepest and most liquid fixed income market in the world, it is clear that both the official sector and the public need improved access to transaction-level data

Treasury Market Reform Progress and Priorities:

[Antonio Weiss, Counselor to the Secretary, U.S. Department of the Treasury](#)

Data

Once implemented next July, the FINRA Trade Reporting and Compliance Engine (TRACE) reporting rule will capture roughly 90% of Treasury market transactions. While data collection from inter-dealer platforms will capture PTFs' trades, it will not provide the participant-level granularity that would accompany direct PTF reporting. Treasury strongly supports registration of all PTF entities that transact in our nation's debt.

Oversight

FINRA rules that address front running of block transactions will provide investors with common sense protections available in other markets. We strongly support applying the SEC's Reg ATS to Treasury platforms. While some platforms have registered and others are considering this step, eliminating this regulatory loophole is inevitable and necessary. We fully support the SEC's efforts on both ATS and PTFs and encourage timely resolution of both matters.

CFTC's Reg AT addresses the risk of automated trading and futures markets, which we believe advances important oversight goals. When finalized, this will update the risk management framework for Treasury derivatives, and we look forward to its finalization and implementation as soon as possible.

Transparency

Of those commenters that addressed data dissemination in their request for information (RFI) responses, one-third expressed concerns regarding public dissemination, asserting that transparency would impair liquidity in the secondary market and increase the costs of market making. Those who favored greater public transparency highlighted the enhanced potential for market participants to assess quality of execution, promote competition, encourage new entrants, strengthen risk management practices, and foster a more resilient market structure. Pre-trade transparency in the Treasury market, given its structure, is not a step we would recommend at this time and requires further study.

Panel One: Data Reporting and the Cash U.S. Treasury Market

Comments and Open Discussion

Deirdre Dunn, Managing Director, Citigroup: To our customers, liquidity is the importance of moving amounts of risk without a visible footprint or impact on the market. In regard to post-trade transparency, we frequently see compression or reduction of price dispersion. It is important to consider the future change that can continue to develop, and regulators should be flexible. Liquidity

does vary throughout the course of the day and the week, particularly with regard to Treasury auctions.

Michael Fleming, Vice President, Federal Reserve Bank of New York: When it was first introduced, TRACE collected data for all corporate bond issuances and phased in dissemination. Increased transparency can lead to better informed customers thus increasing liquidity and improving dealers' access to bonds and lower transactions costs; however, increased transparency can also decrease liquidity. Academic studies have shown that TRACE helped lower transaction costs and trading activity did not suffer.

Steven Joachim, Executive Vice President, FINRA: FINRA has several principles in regard to data collection and dissemination. The approach we take reflects the existing market structure, rather than vice versa; we want reporting rules to reflect market processes. There will be complexities for many firms, and we need to let our rules and approach evolve to allow firms to adapt. FINRA adjusts its reporting timeframes to address reporting requirements, and data dissemination should address the most liquid and least controversial market segments first. We do not want to make this so complex that people cannot understand the data when they receive it.

Adam Nunes, Head of Business Development, Hudson River Trading: Transparency in much less-liquid markets than Treasuries has led to better results. Transparency will be beneficial with regard to costs to investors, end users, and price efficiency. Ultimately, this is not about whether transparency benefits one market maker or another; it is whether its benefits are seen across the market.

Gerald Pucci, Managing Director, Blackrock: The definition of liquidity is changing second by second and is very customer dependent; it is not so much a market issue as it is a client issue. Global managers will be hampered with a shortened timeframe of price discovery, but the market will adapt. The cost of a mistake is far greater in the Treasury market than in the corporate bond market or mortgage market.

Sayee Srinivasan, Chief Economist, CFTC: Post-trade transparency is critical for all market participants. There are challenges in terms of getting time stamps correct and coming up with product identifiers. The large institutional traders already have a high level of transparency, and we rarely hear complaints that transparency has impacted liquidity. The data will help us calibrate the reporting framework.

Morning Keynote Address: [The Honorable Timothy Massad, Chairman, CFTC](#)

"Flash Crashes"

I would like to talk about the recent event involving the British pound and how it compares to the October 15, 2014 Treasury event. My focus will be on the activity observed in the futures market during the event window. On October 15, we saw an event marked by relatively smooth movements, thus no Treasury market halts were triggered that morning. In contrast, during the pound market event, there were a couple of velocity logic pauses and a trading halt. Stop orders were present during that event, but they did not play a significant role. This comparison underscores the importance of having good data, which is especially true where the major derivatives participants are often some of the major participants on the cash side as well.

Reg AT

These events also underscore the current speed and complexity with which markets operate, which is why CFTC is continuing to work on Reg AT. Reg AT requires certain pre-trade controls and other measures, such as message throttles and maximum order size limits. It requires other measures such as “kill switches,” which facilitate emergency intervention in the case of a malfunctioning algorithm. While our original proposal called for risk controls at three levels (exchange, FCM, and trader), I am in favor of a two-tiered structure: the exchange level and either the trader or FCM level, but not both. In addition, many commenters said the controls should pertain to all electronic trading, not just algorithmic trading, which I support. Our supplemental proposal to Reg AT had a registration requirement and some felt the proposal as originally drafted was too broad. I believe our focus should be the most active firms, so we are looking at whether to add a volumetric test.

Panel Two: Treasury Secondary Market Clearing Practices

Open Discussion

Isaac Chang, Managing Director, AQR Capital Management: Transparency and ensuring there is enough capital to survive stress events is important. If you look at inter-dealer broker (IDB) practices, they do require collateral-like deposits, which translates into potential limits. The current regulatory structure has left our asset management firm with fewer trading partners because entities cannot meet capital requirements and are being closed.

Giuseppe Nuti, Managing Director, UBS: I do not think margin practices have kept up with market developments. When there is market stress, it helps to have a transparent margin requirement that everyone can see.

Murray Pozmanter, Managing Director, DTCC: A voluntary move into clearing is unlikely without a catalyst. From our perspective, IDBs are really the only market participants who are net flat throughout the day. If you have any market stress that could take down an IDB, that could transmit losses onto other members of the clearinghouse. We are looking at distributed ledger technology for our central clearing and our swap data repository (SDR) operations.

John Shay, Senior Vice President, NASDAQ: There needs to be a mechanism in place that will allow the cash Treasuries market to withstand any level of shock and remain above the fray. With the right clearing solution in place, you could quickly allow the markets to feel they are on a better footing. IDBs take all this bid and offer risk and match it together, and the more netting you have, the safer it is.

Stuart Wexler, General Counsel, ICAP: Within the current market setup, if you have those who trade above a certain threshold use a clearinghouse or prime broker, it can help address some of the issues in the Treasury markets. We assign a level of creditworthiness to each of our customers and place a limit on what they can trade intraday. Blockchain may make it easier to do some transactions at the close of the trading day.

Lunch Keynote Address: [The Honorable Mary Jo White, Chair, SEC](#)

Regulatory Oversight and Reporting of Trades in U.S. Treasury Securities

I believe our regulation of the equity markets can and should be deployed to strengthen the U.S. Treasury market. It is important that regulators have comprehensive data of the Treasury market, and the Commission took an important step to further this goal by approving the FINRA rule to provide regulators with access to trading data for U.S. Treasury securities. All broker-dealers registered with the SEC that are FINRA members will be subject to this transformative rule. I am very pleased that the Fed announced last Friday that it intends to collect Treasury securities transaction data from banks, with the possibility that FINRA may act as agent on the Fed's behalf for such collection.

Foundational Regulation of Trading Platforms and Dealers

I have asked the staff to recommend ways of extending aspects of our securities regulatory framework to Treasury market intermediaries. I have also directed staff to develop recommendations for the Commission to consider applying measures that would further enhance our regulation of platforms that trade government securities. I expect these recommendations to address whether and how to apply the various provisions of Regulation ATS and Regulation SCI to platforms that currently trade government securities. Although some PTFs are clearly engaged in dealer activity, and we are closely looking at that activity, I have asked SEC staff to consider further clarifying how the conduct of PTFs may trigger dealer registration requirements, whether that conduct is in the Treasury or equity securities markets.

FINRA Review of Rules Relating to U.S. Treasury Market

FINRA staff expects to present a proposal on a range of Treasury issues to its Board of Governors in the first quarter of 2017. FINRA staff noted, for example, that it may be appropriate to apply rules addressing front running of block transactions, prohibitions against trading ahead of customer orders, trading ahead of research reports, and certain conflicts of interest provisions to the government securities market.

Panel Three: The Future of Treasury Market Settlement

Open Discussion

Phil Davies, Managing Director, Morgan Stanley: Our concern is not to lose focus on other things going on in global financial reform, as well as the Treasury settlement business, since we do not have to do any specific migration. Resilient, robust operations with great transparency are vital to the settlement market.

Gerald Hassell, CEO, Bank of New York Mellon: We are in a unique position of helping shape the capital markets and provide the critical infrastructure to make the financial markets work. We are using a form of distributed ledger technology but have yet to make that information available to the Fed or our clients. Our first priority is to make sure our existing clients are successfully transitioned to our new platform. Resiliency is one of the most important aspects of market operations.

Shane Ó Cuinn, Managing Director, Credit Suisse: JPMorgan's exit has impacted the repo market over the past few months. Repo market participants and those who rely on those markets have dealt with a very tumultuous past few months. While we would not have wished for a single entity repo market, people are focused on getting the repo market up and running on a single system. The transition needs to happen as seamlessly as possible, but there is a risk it could be too staggered.

Murray Pozmanter, Managing Director, DTCC: We are looking at whether there is a way to centralize a lot of the activity that currently moves across Fedwire. It is about creating a centralized utility where custodians would be participants and relieving some of the stress at the end of the day that occurs in the tri-party repo market. A utility like this would need a critical mass to work effectively and getting a critical mass from the market would be the biggest hurdle.

Brian Ruane, CEO of Broker-Dealer Services, Bank of New York Mellon: Over the past four years, we removed 97% of the risk in the tri-party repo market, which was about \$1 trillion. We also created some client innovations, including automated deal matching and collateral optimization. Together, we can all work to achieve goals and implement technology.

Panel Four: Evolution of Treasury Market Structure

Open Discussion

Alain Chaboud, Principal Economist, Board of Governors of the Federal Reserve System: I think we are probably going to more of an all-to-all solution. The role of banks will not return to their old glory, and PTFs will become more important.

Dan Dufresne, Treasurer, Citadel: There are two areas where the market will be different five years from now: what we will see as market participants, and where we trade, will continue to evolve. PTFs will probably be more regulated in the near future, but many large participants in the market are already regulated. We want venues competing to offer the most attractive, resilient marketplace. There will likely be more intraday volatility.

Ryan Sheftel, Global Head of Fixed Income, Global Trading Systems: There will likely be more automated trading on behalf of end clients, but traditional dealers will maintain their role in executing complex trades. PTFs are held to a very high standard to stabilize stocks in certain scenarios, and there could be huge benefits to the Treasury market if PTFs were to play a similar role as they do in equity markets.

Tom Wipf, Managing Director, Morgan Stanley: If we were having this panel five years ago, I do not think we would be having this discussion about clearing and CCPs. Collaboration among market participants is necessary for any type of infrastructure change to occur. I think clearing is central to the advancement of liquidity.

Mihir Worah, Managing Director, PIMCO: For the Treasury market to evolve, the Treasury or Fed would need to provide some liquidity solution for off-the-run securities. There should be no expectation that asset managers will be liquidity providers at the micro level. Even though at the macro level regulations have made banks safer, there are going to be more flash events. I think Treasury markets are going all-to-all with two or three platforms dominating but not fully like the equity markets.

Concluding Remarks

[Daleep Singh, Acting Assistant Secretary for Financial Markets, U.S. Department of the Treasury](#)

Since the financial crisis, Treasury has executed one of its fastest maturity extensions in modern history by increasing the weighted average maturity of our marketable debt portfolio from 48 months to 70 months. Treasury has also taken several key steps to reduce operational risk in debt management,

including a change to its cash balance policy and strengthening its contingency planning. An implicit objective is to foster liquidity that allows the market to function even in times of stress, allowing willing buyers to trade with willing sellers. Post-crisis reform has created more resilient financial institutions through stronger capital buffers, safer funding profiles, robust stress testing, better managed and more transparent counterparty risk, and credible resolution tools.