

Statement

Statement on 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



Commissioner Caroline A. Crenshaw

Sept. 14, 2022

As I have noted in the past,[\[1\]](#) it is hard to overstate the importance of the U.S. Treasury market. U.S. Treasury securities are direct obligations of the U.S. Government issued by the Department of the Treasury. There are several different types of Treasury securities, including U.S. Treasury bills, nominal coupon notes and bonds, Floating Rate Notes, and Treasury Inflation-Protected Securities (TIPS). The market consists of two components: the primary market and the secondary market. The primary market is where the Treasury Department auctions securities to the public through a competitive bidding process and subsequently issues awarded securities to finance the Federal government. The secondary market is where the other trading of U.S. Treasury securities occurs. The secondary market includes both the “cash market,” for outright purchases and sales of securities, and the repo market, where one participant sells a U.S. Treasury security to another participant, along with a commitment to repurchase the security at a specified price on a specified later date. Treasuries serve as investment instruments and hedging vehicles, as a benchmark for many financial instruments, and as a mechanism for the implementation of monetary policy, among other purposes.

With thanks to my colleagues in the Division of Economic and Risk Analysis, I will briefly highlight a few statistic to help illustrate the importance of the Treasury market:

- Average weekly trading volume in the Treasury cash market is approximately \$3 trillion[\[2\]](#);
- Average daily volume in the Treasury repo market is almost \$4 trillion[\[3\]](#);
- The total amount outstanding of marketable U.S. Treasury securities held by the public is around \$23 trillion[\[4\]](#); and
- Trading in the U.S. Treasury market accounts for approximately 65% of all trading in fixed income securities[\[5\]](#).

For these and other reasons, the U.S. Treasury market is often referred to as the deepest and most liquid market in the world.[\[6\]](#) Confidence in the Treasury market is central to the functioning of the U.S. financial

system, and to the global economy more broadly.

The structure of the Treasury market has undergone significant changes over the last 20 or so years.^[7] Many of these changes stem from the increased use of technology and automation, and the emergence of the Principal Trading Firm (PTF) entities that have deployed technology-based trading strategies.

Before the mid-2000s, most interdealer trading occurred between primary dealers, and the transactions were centrally cleared – that is, cleared and settled by a central counterparty that interposes itself between the counterparties to the transaction, acting functionally as the buyer to every seller and the seller to every buyer, thus reducing the risk that a transaction will fail and increasing efficiency.^[8] However, in recent years, the share of trades on interdealer broker platforms executed by non-dealers, like PTFs and hedge funds, has grown, with a corresponding decrease in the level of central clearing.^[9]

There have also been a number of recent disruptions in the Treasury market, including the flash rally of October 2014, the sudden spike in repo rates in September 2019, and the Covid-related market disruption in March 2020. These events triggered extensive interventions by the Federal Reserve and have prompted regulators, industry groups, and academics to consider ways to improve the resilience of the market in times of stress. Increasing the level of central clearing in the Treasury market has been identified in numerous papers, reports, and speeches as one way to do so.^[10]

The amendments we are considering today are designed to promote central clearing in the Treasury market in four ways:

- First, the proposal would require covered clearing agencies that clear Treasury securities (currently, only the Fixed Income Clearing Corporation) to require all of their direct participant members to submit eligible secondary market transactions in Treasuries for clearance and settlement;
- Second, the proposal would require certain changes to strengthen risk management practices at covered clearing agencies that clear Treasury securities, specifically with respect to the separation of margin for proprietary positions from margin for other transactions;
- Third, the proposal would require a covered clearing agency that clears Treasury securities to ensure that it has appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in U.S. Treasury securities, including those of indirect participants;
- Finally, the proposal would amend the broker-dealer customer protection rule to permit margin required and on deposit with covered clearing agencies for Treasury securities to be included as a debit in the reserve formulas for accounts of customers and proprietary accounts of broker-dealers.

The potential benefits of central clearing are numerous. Increased central clearing in the Treasury market should decrease the overall amount of counterparty risk, reduce contagion risk to the Fixed Income Clearing Corporation,^[11] help avoid disorderly member defaults, and increase multilateral netting of transactions, which should in turn reduce operational and liquidity risks.^[12]

It should also improve transparency in several ways. First, expanded central clearing should increase regulators' visibility into these markets, in particular the often opaque repo market.^[13] It should also improve transparency of settlement risk to regulators and market participants,^[14] and increase price transparency.^[15]

There are other considerations. In particular, while central clearing reduces counterparty and operational risks, it also concentrates risk in one entity.^[16] This underscores the importance of effective risk management at clearing agencies, and of the importance of appropriate supervision and regulation for those institutions. There could also be an increase in the cost to participate in the Treasury market associated with the amendments. However, additional costs are likely to be offset by the netting benefits that should result from additional centrally cleared transactions.^[17]

Some may query whether a requirement for FICC members to clear eligible secondary market transactions is necessary, given that the amendments to the customer protection rule and changes to margin practices may,

on their own, result in an increase in the level of central clearing in the Treasury market. However, as noted in the release, the benefits of central clearing are proportional to the number of participants.^[18] The higher the number of participants, the greater the benefits of central clearing. And central clearing requires participants to incur short-term, private costs in order to obtain a larger, longer-term collective benefit. In other words, central clearing can present a collective action problem, and in the absence of a meaningful inducement to partake, market participants may not do so. The proposal would provide that inducement through the membership requirements, and I therefore consider that aspect of the proposal foundational.

I look forward to reviewing the comments. In particular, I look forward to commenters' views on the scope of the proposed requirements regarding direct member transactions in the secondary market, and whether they may be under- or over-inclusive. I am also interested in commenters' views on appropriate schedule for implementation.

Finally, I'd like to join my colleagues in thanking our fellow regulators for their input, in particular through their participation in the Inter-Agency Working Group on Treasury Market Surveillance, comprising staff from the Department of Treasury, the Federal Reserve Board of Governors, the Federal Reserve Bank of New York, the Commodity Futures Trading Commission, and the SEC. I'd also like to thank the staff of the Division of Trading and Markets, the Division of Economic and Risk Analysis, and the Office of the General Counsel for all of their hard work on this proposal. I'm pleased to support it. Thank you.

[1] See Commissioner Caroline A. Crenshaw, [Statement on Amendments to Exchange Act Rule 3b-16, Regulation ATS, and Regulation SCI](#) (Jan. 26, 2022); see also Commissioner Luis A. Aguilar, [Ere Misery Made Me Wise - The Need to Revisit the Regulatory Framework of the U.S. Treasury Market](#) (July 14, 2015).

[2] Average weekly trading volume in the secondary market for U.S. Treasury securities was approximately \$3 trillion in 2021, with notable peaks in March 2020 and early 2021. See [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](#), Securities Exchange Act Release No. 34-95763 (September 13, 2022) (the "Proposal") at 138.

[3] Throughout 2020 and into 2021, daily transaction volume in the U.S. Treasury securities repurchase market ranged between \$1.5 and \$2.5 trillion per day. Since April 2021, average daily volume has been considerably higher – approaching \$4 trillion per day – coinciding with the growth in the Federal Reserve's overnight reverse repurchase operations. Proposal at 141.

[4] As of June 30, 2022, the total amount outstanding of marketable U.S. Treasury securities held by the public was \$23.3 trillion. This includes \$3.5T in bills, \$13.6T in notes, \$3.8T in bonds, 1.8T in TIPs, and 0.6T in floating rate notes. The volume of marketable U.S. Treasury securities outstanding has increased by approximately \$18 trillion since 2000. Proposal at 137.

[5] According to industry reports, 65% of the \$955.2 billion in average daily trading volume of U.S. fixed income securities in 2021 was in U.S. Treasury securities. Proposal at 137.

[6] See, e.g., U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading Commission, [Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report](#) (November 8, 2021) at 1.

[7] *Id.* at 7.

[8] *Id.* at 5-6; Proposal at 10.

[9] Unlike the interdealer market, the dealer-to-customer market has historically been a bilateral market with little central clearing. Proposal at 26.

[10] See, e.g., U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading

Commission, [Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report](#) (November 8, 2021); FIA Principal Traders Group, [Clearing a Path to a More Resilient Treasury Market](#) (July 2021); Treasury Market Practice Group, [White Paper on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities](#) (July 2019); Nellie Liang and Pat Parkinson, [Enhancing Liquidity of the U.S. Treasury Market Under Stress](#) (December 16, 2020); Commissioner Elad Roisman, [Remarks at U.S. Treasury Conference](#) (September 29, 2020).

[11] The Fixed Income Clearing Corporation (FICC) is currently the only covered clearing agency that provides central counterparty services for transactions in U.S. Treasury securities.

[12] Proposal at 73.

[13] Proposal at 76.

[14] Proposal at 76.

[15] Proposal at 225.

[16] See U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading Commission, [Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report](#) (November 8, 2021) at 31.

[17] Proposal at 217-18.

[18] Proposal at 237.