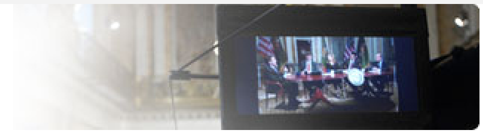

Remarks by Acting Assistant Secretary for Financial Markets Daleep Singh at the SIFMA Fixed Income Market Structure Seminar

5/24/2016

NEW YORK - Good afternoon. I would like to thank SIFMA for inviting me here today to speak at this year's Fixed Income Market Structure Market Seminar. As always, we appreciate the opportunity to engage with market participants on subjects of shared importance. In addition to hosting events such as this, SIFMA also provides support to Treasury through the Treasury Borrowing Advisory Committee, and I'd like to also express our thanks for those contributions.

In my capacity as Acting Assistant Secretary for Financial Markets, I advise the Secretary of the Treasury on policy matters related to debt management, financial markets, and regulation. The office that I oversee worked with the Federal Reserve Bank of New York, the Federal Reserve Board, the SEC, and the CFTC to produce the Joint Staff Report on the U.S. Treasury Market regarding the events of October 15, 2014. The Joint Staff Report provided some answers to questions many had about the events of that day, but it also made clear that further work on the evolution of the Treasury market is appropriate and timely.

As highlighted in the Report, advancements in technology and growth in high-speed electronic trading are changing the nature of market intermediation and the provision of liquidity in fixed income markets. To learn more about these changes, Treasury issued a Request for Information (RFI), seeking public comment in four areas: (1) the evolution of the U.S. Treasury market and implications for market structure and liquidity provision, (2) trading and risk management practices and market conduct, (3) official sector access to Treasury cash market data, and (4) public reporting of Treasury cash market transaction data.

Today I'd like to share with you some of what we've learned from these comments, as well as some of the next steps we intend to take as a result of this review – the most comprehensive assessment of the Treasury market since the 1990s. The insights from those comments will inform our analysis of the current market structure for Treasuries and help us consider how to design policy for the future state of the Treasury market.

TREASURY MARKET DATA AVAILABLE TO THE OFFICIAL SECTOR

It became clear early on in our review that the official sector needs access to more data for a comprehensive and regular assessment of developments across Treasury markets. A significant portion of the time it took to produce the Joint Staff Report was related to data collection. The only data readily available are futures market transaction reports provided to the CFTC. Information on activity in cash Treasury markets is not readily accessible, and the official sector lacks visibility into dealer-to-customer activity, which, according to some estimates, is over 50 percent of the cash market.

Respondents to the RFI were nearly unanimous in their support of the collection of transaction data by the official sector. Of the 31 respondents who addressed the topic, 29 agreed that the official sector should have access to more Treasury market trading data. Furthermore, respondents broadly encouraged Treasury to leverage existing infrastructure to collect Treasury market trade data, which would lighten the burden of compliance for those reporting data, particularly smaller firms. The Financial Industry Regulatory Authority's (FINRA's) Trade Reporting and Compliance Engine (TRACE) was cited most often as the best tool for doing so.

Consistent with this feedback, last Monday, Treasury and the SEC jointly announced a request for FINRA to develop a proposal requiring member broker dealers to report Treasury cash market transactions to a centralized repository. While any proposal by FINRA to require reporting of Treasury cash market activity would be subject to review and approval by the SEC, in consultation with Treasury, this announcement is an important first step toward enhanced official sector data collection.

Treasury and the SEC also announced that we will continue to work with other agencies and authorities to develop a plan for collecting cash transaction data from institutions that actively trade U.S. Treasury securities but are not FINRA members. Treasury intends to have a comprehensive plan to collect cash market data in place by year-end. These steps will be critical toward achieving our longer-run goal, identified in the Joint Staff Report, of giving us access to "confidential, non-public data, information, and analysis related to cash securities and futures markets on an ongoing, and event driven, basis."

TREASURY MARKET DATA AVAILABLE TO THE PUBLIC

While support for official sector data collection was nearly unanimous in the RFI comment letters, support for public dissemination of Treasury market trading data was far more mixed. SIFMA, as well as several primary dealers, argued that rapid and highly specific public post-trade reporting would impair liquidity in the Treasury market. Commenters that favored public post-trade reporting tended to be newer entrants to the market. These institutions argued that the additional transparency provided by the publication of post-trade information would enhance liquidity and efficiency in the Treasury market.

What became clear in the RFI comments is that there are existing and potentially new benefits to post-trade transparency in Treasuries, but there are potential costs as well. Transparency could enhance market participants' capacity to assess the quality of their execution, and in doing so may promote competition, improve market access, strengthen risk management practices, and encourage a more resilient market structure. Several commenters observed that in the Treasury futures market—a market that differs in important ways from the cash market— both a healthy state of liquidity and a high degree of public transparency can co-exist.

At the same time, we must recognize potential costs associated with additional transparency, especially if it complicates the redistribution of risk, discourages price formation, or compromises the ability of market-makers to satisfy client obligations. For example, some RFI commenters suggested that investors with large positions, or those intermediating large transactions, would incur increased risk when trading in an environment of enhanced post-trade transparency. They suggested these risks could be large enough to materially affect the economics of block trading and, in turn, could lead to a decrease in Treasury market liquidity. Other commenters suggested that post-trade transparency could raise the expected and realized costs of hedging, which could also lead to diminished risk transfer in Treasury markets.

Needless to say, we are carefully analyzing all of these issues before we move forward with any detailed policy proposals. Any public post-trade transparency in the Treasury cash market would be carefully tailored to maximize the benefits while minimizing costs. Indeed, even commenters who strongly advocated for additional post-trade transparency urged that careful attention be paid to the modalities of reporting requirements in order to mitigate the potential costs. For example, many of these commenters stated that the reporting of off-the-run Treasury trades should come with a longer delay than the reporting of on-the-run Treasury trades. Others argued that the size of block trades over a certain notional threshold should not be disclosed, even after lengthy delay. As part of our analysis, we intend to study the experience of other markets, both domestic and international, that have introduced varying degrees of public disclosure.

We are also mindful that it would be premature to develop any proposal for public disclosure before the official sector has access to and can analyze a sufficient level of Treasury trade data. In the meantime, we welcome further discussion with market participants and industry observers to help us refine our thinking and develop, over the coming months, an appropriate set of principles on whether Treasury market data should be made available to the public.

REGULATORY OVERSIGHT

Another key topic raised by several respondents to the RFI was the scope of regulatory oversight in the Treasury market.

As you all know, principal trading firms (PTFs) have become significant participants in the secondary markets for Treasuries, particularly for on-the-run securities. PTFs now account for the majority of trading and standing quotes in the order book in both the Treasury futures and the interdealer cash market. By contrast, while banks and broker dealers still account for a majority of secondary cash market trading overall, they comprise well under half of the trading and quoting activity in the interdealer cash market. Yet, as some RFI commenters pointed out, many PTFs are not subject to SEC oversight because they are not registered as broker-dealers. This, some commenters noted, has the potential to create an “uneven playing field,” so to speak, and perhaps even opportunities for regulatory arbitrage.

A separate set of observations on regulation was related to the application of SEC Regulation Alternative Trading System (or Reg ATS) to major electronic platforms for Treasury security trading. Generally speaking, trading platforms may either register as exchanges or provide notice that they will operate alternative trading systems, or “ATSs.” However, at the time the SEC adopted the ATS regulatory structure in 1998, it chose to exclude from that regulation platforms that trade solely government securities. Broker-dealers that operate electronic platforms trading exclusively in government securities are thus exempted from filing Form ATS. The SEC recently proposed a number of significant enhancements to the ATS regulatory scheme, and although the Commission did not propose to remove that exemption, it did ask questions about it. Some respondents to the SEC proposal noted that removing this exemption could be beneficial. For example, the fair access provisions of Reg ATS could open the interdealer market to a wider array of participants, including traditional buy-side firms. In addition, it could also have the effect of requiring more disclosure of platform operations.

In the coming months, we will continue our ongoing consultation and dialogue with members of the Inter-Agency Working Group and other members of the official sector to appropriately address these important issues.

CENTRAL CLEARING IN TREASURY MARKETS

A final theme I will highlight from the RFI commentary was the general support for broader participant membership in the central clearing of cash Treasury transactions. As with the question of post-trade data reporting to the public, this is a topic that Treasury intends to analyze closely before any policy recommendations are made.

For context, central clearing for cash Treasury transactions has existed since the mid-1980’s, when firms began clearing through the Fixed Income Clearing Corporation’s (FICC) predecessor. The FICC model for central clearing and the regulatory framework surrounding it—mainly the purview of the SEC—have worked well for many years, in part because FICC’s largest member firms are all SEC-registered brokers and dealers subject to a comprehensive regulatory regime.

Today, PTFs represent a large volume of transactions on interdealer trading platforms for cash Treasuries. Many PTFs are not members of FICC, and, as a result, their trades are not directly cleared by the central counterparty. Commenters noted that, over time, this has led to a decline in centralized clearing and settlement in the Treasury market as a whole, with important consequences for Treasury to consider.

Increased participation in centralized clearing for cash Treasuries could have the beneficial effect of reducing the aggregate amount of counterparty and credit risk in the system. On the other hand, as some note, if the increased costs of central clearing drive certain liquidity providers out of the market, such as the high-volume, low-margin market making activities conducted by PTFs, it could reduce efficiency and resilience in the market.

It is my understanding that FICC and some PTFs have begun a conversation on the obstacles to PTF membership in FICC. Though the discussions appear to be at an early stage, we encourage them to continue. Ultimately, in order to make central clearing of Treasury trades viable to a diverse and resilient base of market participants, pragmatic compromise will be needed for the benefit of the system as a whole. Some parties may have to accept increased fees for clearing and settlement, and other parties may have to accept that margining and collateralization practices need to be updated to reflect the fact that trading occurs at much higher speeds now than it did in the past.

CONCLUSION

To summarize, Treasury intends to remain actively engaged on a number of fronts to execute the post-RFI roadmap I have laid out today.

First, we will focus on developing a comprehensive plan to collect data on cash Treasury market activity from all major market participants.

Second, we will consult with market participants to define an appropriate set of principles that would guide any decision on whether to make this data publicly available. To reiterate, we do not anticipate developing any policy proposal on the public availability of data until the official sector has access to cash market transaction data.

Third, as both the official sector and the market develop a better understanding of clearing and settlement in the Treasury market, we will closely monitor the progress that is made toward broadening the use of centralized clearing and settlement services.

Lastly, we will continue our ongoing dialogue with the SEC and other members of the official sector through the Interagency Working Group for Treasury Market Surveillance so that we continue to appropriately oversee and monitor all major Treasury market participants and platforms in the Treasury market.

As a final note, I would encourage everyone to read at least some of the comments that are publically available on the regulations.gov website. You will find that the RFI prompted a healthy discussion on a number of complex issues that we don’t have time to address today but are of great importance to Treasury market structure. Let me underscore that although the RFI response period may have passed, we look forward to your continued feedback on these issues and active dialogue with Treasury. Our hope is that through events such as this seminar we can advance our collective understanding of the issues in front of us and those that lie ahead.

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