

STATUS UPDATE 2022

U.S. Treasury Markets

Steps Toward Increased Resilience



GROUP OF THIRTY

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Abbreviations

ATS	Alternative Trading System
FICC	Fixed Income Clearing Corporation
FIMA	Foreign and International Monetary Authority
FINRA	Financial Industry Regulatory Authority
GSIBs	global systemically important banks
G30	Group of Thirty
IAWG	Interagency Working Group on Treasury Market Surveillance
IDBs	intermediated by interdealer brokers
PTFs	Principal Trading Firms
SCI	Systems Compliance and Integrity
SEC	Securities and Exchange Commission
SIFMU	Systemically Important Financial Market Utility
SLR	Supplementary Leverage Ratio
SRF	standing repo facility
TRACE	Trade Reporting and Compliance Engine



Status Update 2022

In July 2021, the Group of Thirty (G30) published a report entitled *U.S. Treasury Markets: Steps Toward Increased Resilience*. To enhance the liquidity of the Treasury markets under stress, the report made ten recommendations, a central goal of which was to increase, diversify, and stabilize market-making capacity in the Treasury markets. The G30's ten recommendations addressed five sets of key issues: (1) central bank liquidity support for Treasury market functioning, (2) central clearing of trades of Treasury securities and Treasury repos, (3) prudential regulation of dealers, (4) market transparency, and (5) market regulation.

This follow-up report, which has been prepared by the individuals who served as the leadership team for the Working Group that produced the original report, assesses the degree to which actions by U.S. authorities since the original report have been consistent with the ten recommendations. Our review of developments in the Treasury market, including research and analysis conducted since, and recent discussions with market participants and officials in the relevant U.S. agencies, suggests the foundational case for those recommendations remains strong.

Although notable progress has been made on some issues, much more remains to be done. This is not surprising given the complexity of the issues, the formal requirements for agency rulemaking in the United States, and the range of other challenges facing the key agencies with authority over the Treasury market. Nonetheless, as Treasury debt continues to grow rapidly and market-making capacity remains limited and concentrated, the Treasury market almost surely remains highly susceptible to dysfunction under stress, and potential sources of stress are forbidding.

The first section of this report summarizes what has been accomplished and what remains undone with respect to the five sets of issues addressed by the G30 recommendations. The second section offers some suggestions for prioritizing and sequencing reform efforts going forward. An Appendix sets out each of the ten recommendations, reiterates the rationales for the recommendations that were set out in the G30 report, and offers some additional details on progress to date.

Actions to Date Relevant to the G30 Recommendations

CENTRAL BANK LIQUIDITY SUPPORT. On July 28, 2021, the Federal Reserve’s Federal Open Market Committee announced the establishment of two standing repo facilities: a domestic standing repo facility (SRF) and a permanent Foreign and International Monetary Authorities (FIMA) repo facility. The Fed’s primary objective in establishing the SRF was to support the effective implementation of monetary policy rather than to increase intermediation capacity in the Treasury and Treasury repo markets, though in practice it can serve both functions. Perhaps with this goal in mind, the facility did not provide as broad access to the SRF as was recommended by the G30, but instead limited access to primary dealers and banks. The existence of a standing facility helps ensure that in future stress episodes the funding needs of primary dealers and participating banks can be met promptly. However, we continue to believe that providing very broad access would achieve important benefits, including diversifying the supply of Treasury market liquidity under stress and preempting some sales of Treasuries during stress periods. The facts that Treasury market liquidity is still heavily dependent on bank-affiliated dealers and that, as discussed below, those dealers are still subject to regulations that discourage market intermediation, is concerning. The permanent FIMA repo facility is an important step because it is likely to preempt sales of Treasuries under stress by foreign central banks and other monetary authorities. A broader SRF would extend those benefits.

CENTRAL CLEARING. A November 2021 staff progress report by the Interagency Working Group on Treasury Market Surveillance (IAWG) indicated that the U.S. regulatory authorities are evaluating the benefits and costs of expanded central clearing of Treasuries and Treasury

repos.¹ The Securities and Exchange Commission (SEC) is the primary regulator of central counterparties for securities markets, including the Fixed Income Clearing Corporation (FICC), which centrally clears the Treasury and Treasury repo markets.² Soon after release of the IAWG report, SEC Chair Gary Gensler indicated that he had asked his staff to make recommendations regarding central clearing of Treasuries and Treasury repos.³ Chair Gensler recently reiterated his comments on central clearing, indicating that the staff’s recommendations are to cover three sets of issues: (1) steps that the SEC might take to facilitate clearing of dealer-to-client trades, (2) potential enhancements to FICC’s risk management policies and procedures, and (3) measures for broadening the scope of central clearing of Treasuries or Treasury repos.⁴ Obviously, it is too soon to tell the extent to which the SEC ultimately will take steps consistent with the G30 recommendations with respect to clearing, but, with the support of the other agencies, it seems to be committed to addressing these complex and important issues promptly, thoroughly, and methodically.

PRUDENTIAL REGULATION OF DEALERS. The liquidity of the Treasury markets under stress is reliant on a small number of very large broker-dealer affiliates of U.S. global systemically important banks (GSIBs). In large measure because of the massive expansion in recent years of the Federal Reserve’s balance sheet (and the accompanying expansion of central bank balances on bank balance sheets), risk-insensitive leverage ratios (notably, the Supplemental Leverage Ratio [SLR]) have become the binding regulatory constraint on the allocation of capital for most of the banks whose dealer subsidiaries are the largest providers of liquidity to the Treasury markets. In April 2020, concerned that the SLR may have been contributing to dysfunction in the

1 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, and U.S. Commodity Futures Trading Commission 2021.

2 In addition, FICC has been designated a Systemically Important Financial Market Utility (SIFMU) under Title VIII of the Dodd-Frank Act, which gives the Federal Reserve certain limited authorities with respect to the supervision of FICC. FICC also centrally clears certain types of U.S. agency debt and agency mortgage-backed securities.

3 Gensler 2021.

4 Gensler 2022.

Treasury market and otherwise limiting banks' capacity to intermediate to the extent required by the COVID-19 pandemic, the Federal Reserve allowed banks to deduct deposits at Federal Reserve Banks and holdings of Treasury securities from the denominator of the SLR on a temporary basis. A year later, the Federal Reserve allowed this temporary relief to expire but announced in a press release that it "will soon be inviting comment on several potential SLR modifications."⁵ No such request for comment has yet been issued, although we understand that Federal Reserve staff are continuing to study potential SLR modifications. With the continued growth of marketable Treasury debt and central bank holdings of Treasuries continuing to decline, the lack of action on the SLR is especially concerning.

MARKET TRANSPARENCY. The Federal Reserve and the SEC have taken steps toward capturing nearly all transactions in Treasury securities in the Trade Reporting and Compliance Engine (TRACE) reporting system operated by the Financial Industry Regulatory Authority (FINRA). Last fall, the Federal Reserve finalized a rule that requires banks that are active in the Treasury market to report transactions to TRACE. In March 2022, the SEC proposed rules broadening the definition of a dealer that would require Principal Trading Firms (PTFs) and firms conducting similar activities to register with the SEC as dealers and to become a member of a self-regulatory organization. If they choose to become a member of FINRA, this would have the effect of requiring them to report their Treasury transactions to TRACE.⁶ As yet, the authorities have taken no steps to publicly disseminate TRACE data on individual Treasury transactions, as

the G30 recommended. However, in a recent speech, SEC Chair Gary Gensler indicated that he thinks that, once reporting of TRACE data is broadened to include banks and PTFs, public dissemination would be appropriate.⁷ A few days thereafter, Treasury announced that it intends to issue a request for information to gather public input on the potential benefits and risks of specific steps that could be taken to provide additional transparency in the Treasury securities market.⁸ The G30 report observed that another important dimension of market transparency is with respect to the rules of trading platforms for Treasury securities, which have been exempt from certain regulations (Regulations ATS and SCI)⁹ that achieve public transparency for trading platforms for equities. In January 2022, the SEC proposed a new, broader definition of "exchange" that would have the effect of covering the principal interdealer and multidealer-to-client platforms for Treasury securities and therefore require them to provide public transparency (and fair access) by complying with Regulations ATS and SCI.

MARKET REGULATION. The G30 report observed that the U.S. Treasury markets have been exempted by law or regulation from many provisions of U.S. securities laws, with many of these exemptions dating to the 1930s, when the Treasury markets were smaller and less important to domestic and global financial stability. It recommended a study of those exemptions and their rationales. There seems to be no enthusiasm for such a broad study. The regulatory authorities are focusing their resources on addressing the issues identified in the IAWG report, which include all the other issues identified in the G30 report.¹⁰

5 Federal Reserve 2021.

6 If a significant portion of PTFs choose not to become FINRA members, the SEC may need to take additional steps to capture their transactions in TRACE.

7 Gensler 2022.

8 U.S. Department of the Treasury 2021.

9 ATS = Alternative Trading Systems; SCI = Systems Compliance and Integrity.

10 In addition, the IAWG report indicated that the authorities were examining the effects of leverage and liquidity risk management practices of certain open-end funds and hedge funds. Although these issues were not addressed in the G30 report, measures to limit potential liquidity pressures in the Treasury market from sales by these types of funds clearly are worthy of further study.

Suggestions for Prioritizing and Sequencing Treasury Market Reform Efforts

U.S. Treasury debt outstanding continues to grow rapidly, and market-making capacity remains limited and concentrated. Consequently, the Treasury market remains susceptible to dysfunction under stress, and potential sources of stress seem abundant and obvious to anyone who follows the daily news. Thus, the uneven progress of Treasury market reform, although understandable, is concerning. The following four measures still seem to be especially promising means of increasing the resiliency of the U.S. Treasury markets.

1. REALIGN BANK LEVERAGE AND RISK-BASED CAPITAL REQUIREMENTS

As noted above, the liquidity of the Treasury markets under stress is reliant on a small number of very large broker-dealer affiliates of U.S. GSIBs. With leverage ratios, especially the SLR, currently the binding regulatory constraint on capital allocation at many of these banks, they are discouraged from allocating capital to market intermediation in the Treasury markets and especially in the Treasury repo markets, the liquidity of which is critical to all dealers in Treasury securities and other leveraged providers of Treasury market liquidity. Thus, banking regulators should adjust leverage and risk-based capital requirements to ensure that leverage requirements are backstops to risk-based requirements rather than binding constraints on bank behavior. There are various alternatives for accomplishing this, as is well understood by Federal Reserve staff. It does not seem to be technical questions that are holding up implementation. Rather, it is a view by some that any loosening of leverage restrictions necessarily would weaken the resilience of these banks and of the banking system as a whole. This view would be correct if leverage requirements were the only requirements applied to bank capital levels. But banks are also subject to risk-based requirements, which Basel III has been making more robust. Banking regulators can and should assess the impact of changes to leverage requirements on bank resilience, but if those changes would result in a banking system that is less resilient than they desire, they simply can tighten risk-based requirements to maintain the system's resilience. U.S. banking regulators are currently at work finalizing implementation of Basel III

in the United States. In that context, they can ensure that leverage ratios return to functioning as backstops to risk-based requirements.

2. CREATE A ROADMAP FOR PUBLIC DISSEMINATION OF TRACE DATA

As noted above, U.S. regulators are on a path to achieving essentially complete coverage of all transactions in U.S. securities in the TRACE reporting system. However, no transaction-level TRACE data, even historical data dating back to 2017, have been disseminated to the public. The G30 report concluded that public dissemination would have important public benefits and that concerns about potential adverse effects on the willingness of dealers to intermediate large block trades in off-the-run-issues could be addressed effectively by capping the reported size of trades in such issues, as has been done for corporate bonds. The SEC, in consultation with the Treasury and drawing on the results of the Treasury's request for information, should provide a roadmap for using the TRACE data to achieve at least as much public transparency for the Treasury market as is currently provided for the corporate bond market. Lingering concerns about adverse effects can best be addressed by initially capping disseminated trade sizes for off-the-run issues at a relatively low amount, assessing the effects, and if no adverse effects are observed, gradually raising the cap. By contrast, delaying dissemination until minutes or hours after a trade is reported could jeopardize achievement of the benefits. We do not believe that there is a compelling case for withholding from the public access to the kinds of transaction-level historical data that the public already has access to for corporate and most other U.S. bond markets.

3. CENTRALLY CLEAR IDB TRADES AND TREASURY REPOS AND STRENGTHEN FICC RISK MANAGEMENT

The complexity of the issues posed by expanded central clearing and the possible need for the SEC to take regulatory action to facilitate clearing of dealer-to-client trades suggest that progress on implementation of the G30's recommendations regarding central clearing may take some

time. Nonetheless, central clearing of trades intermediated by interdealer brokers (IDBs) and Treasury repos should be achieved as promptly as possible, if necessary, through a regulatory mandate, in order to address concerns about systemic risks posed by existing practices.¹¹ IDBs that facilitate anonymous trading by acting as counterparties to trades on their platforms are effectively acting as central counterparties but are not regulated as such. Consequently, mandating clearing of those trades through FICC, which is subject to regulation by the SEC and oversight by the Federal Reserve, would allow regulators to reduce the potential systemic risk that the existing settlement arrangements may pose, which is difficult to assess because the associated risk management practices lack transparency. In the case of Treasury repos, central clearing would address concerns that the low (or even zero) levels of repos currently being collected in bilateral repo markets pose a threat to financial stability. Action by the SEC to propose measures for enhancing FICC's risk management is an important complement to broader central clearing.

4. CREATE A BROADER STANDING REPO FACILITY

The G30 report identified a broad SRF as “the single most important near-term measure that should be undertaken to enhance market-making capacity in the Treasury market...”¹² The SRF that the Federal Reserve created in July

2021 does not provide the very broad access to the facility that the G30 recommended. In part, this reflected that the Federal Reserve's primary stated purpose in creating the facility was supporting the effective implementation of monetary policy. By contrast, the G30 report saw an SRF as a means to diversify the supply of Treasury market liquidity under stress as well as to preempt some sales of Treasuries during stress periods. We believe that this case for a much broader SRF continues to be compelling. The Fed's decision to limit access to primary dealers and banks also may have reflected concerns that broadening access significantly beyond firms that the Federal Reserve regulates¹³ could create moral hazard that would increase systemic risk by encouraging entities with access to the SRF to become more highly leveraged. The G30 report suggested that a practical way in which the Fed could reach a broad range of counterparties would be to clear repos provided by the SRF through FICC. Once the SEC acts to enhance FICC's risk management, this should become a more attractive option. As noted above, because FICC is an SIFMU, the Federal Reserve has certain limited authorities for oversight of FICC. FICC's membership and margin requirements provide mechanisms for limiting leverage by FICC participants. If necessary to limit moral hazard, the Federal Reserve could work with the SEC to strengthen those requirements for FICC participants that choose to access the SRF through FICC.

11 Encouragingly, a report by a group of PTFs supported requiring clearing of their IDB trades, while noting that what they saw as limitations of FICC's existing clearing models would need to be addressed. See FIA Principal Traders Group 2021.

12 Group of Thirty 2021, 7.

13 A handful of primary dealers (those not affiliated with banks) are not regulated by the Federal Reserve.

APPENDIX

Rationales and Implementation Status of the G30 Recommendations for Increasing the Resilience of the Treasury Markets

CENTRAL BANK LIQUIDITY SUPPORT

Recommendation 1: The Federal Reserve should create a Standing Repo Facility (SRF) that provides very broad access to repo financing for U.S. Treasury securities on terms that discourage use of the facility in normal market conditions without stigmatizing its use under stress. It should make permanent its Foreign and International Monetary Authority (FIMA) repo facility.

Rationale: The G30 report observed that the willingness and capacity of firms to make markets is critically dependent on their confidence in their ability to fund inventories of Treasuries that they may acquire as a result of those activities, even under stress. Access to a Federal Reserve liquidity facility that provides repo financing for Treasuries would encourage those with access to increase their capacity to make markets in Treasury securities. The report argued that although broad access (significantly beyond firms subject to prudential regulation by the Federal Reserve) could create moral hazard by encouraging firms to become more highly leveraged, those effects could be addressed by the pricing of repos offered by the SRF to make excessive leverage unattractive and that the SRF would reduce systemic risk in other ways, including by forestalling runs on repo financing and preempting some sales of Treasuries during stress periods.

Implementation Status: On July 28, 2021, the Federal Reserve’s Federal Open Market Committee announced the establishment of two standing repo facilities: a domestic standing repo facility (SRF) and a permanent FIMA repo facility. However, the primary purpose of the SRF seems to be to support effective implementation of monetary policy rather than increasing intermediation capacity in the

Treasury and Treasury repo markets. The facility did not provide broad access but instead limited access to primary dealers and to banks. Limiting access in this way was sufficient to support the monetary policy goal while avoiding questions about how to address concerns that a broad standing repo facility could create moral hazard that would increase systemic risk. The existence of a standing facility helps ensure that in future stress episodes the funding needs of primary dealers and banks in relation to Treasuries will be met promptly. However, by limiting access to these types of active market participants, the Federal Reserve misses an opportunity to diversify the supply of Treasury market liquidity under stress. As the IAWG report observed: “A diverse and competitive set of market makers and investors should foster resilience by rendering market liquidity less susceptible to shocks or environmental changes that affect particular participants or types of participants.”¹⁴ In that regard and as discussed below, nearly all the primary dealers are bank-affiliated entities that are unnecessarily discouraged from allocating capital to Treasury market intermediation when risk-insensitive leverage requirements are binding constraints on capital allocation, as they currently are for many of the largest primary dealers.

CENTRAL CLEARING

Recommendation 2: All trades of Treasury securities and Treasury repos executed on electronic interdealer trading platforms that offer anonymous trading by interposing an interdealer broker between buyers and sellers should be centrally cleared.

Recommendation 3: Treasury repos should be centrally cleared.

¹⁴ 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, and U.S. Commodity Futures Trading Commission 2021.

Recommendation 4: Market participants and regulators should continue to study how dealer-to-client cash trades of Treasuries might best be centrally cleared, including via the sponsored clearing model, and assess the private and public policy cases for central clearing using whatever is the optimal model.

Recommendation 5: The Treasury Department, after consultation with the Federal Reserve, should organize and take responsibility for a joint review of the design and operation of the Fixed Income Clearing Corporation (FICC) by Treasury, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and the Federal Reserve, with a view toward ensuring that the supervision and regulation of FICC is sufficiently robust. FICC should be granted access to the SRF.

Rationale: The G30 report concluded that the public policy benefits and costs of wider clearing of Treasuries and Treasury repos differ for different market segments and transaction types, so the analysis of, and recommendations regarding, wider central clearing must take those differences into account. The report concluded that there was a very strong case for reducing systemic risk by centrally clearing all trades executed on interdealer trading platforms that offer anonymous trading. It also recommended that Treasury repos should be centrally cleared because it would (1) greatly expand the balance sheet capacity of existing repo market intermediaries, (2) expand and stabilize access to repo financing for a broad range of potential liquidity providers to the Treasury markets, and (3) reduce systemic

risk by placing a floor on margin requirements in Treasury repo markets, which competitive pressures have been driving down in recent years, sometimes to zero. Regarding the central clearing of dealer-to-client cash trades, it concluded that the public policy case is not as strong as that for interdealer broker (IDB) trades or Treasury repos. In terms of the potential costs of central clearing, the G30 report noted concerns about concentration of risks and responsibilities for risk management in the central counterparties, which would be even more important if central clearing of Treasuries and Treasury repos became more prevalent.¹⁵

Implementation Status: The IAWG report indicated that the U.S. regulatory authorities are evaluating the benefits and costs of expanded central clearing of Treasuries and Treasury repos.¹⁶ The Securities and Exchange Commission (SEC) has robust statutory authority over securities market central counterparties, including FICC.^{17,18} Soon after release of the IAWG report, SEC Chair Gary Gensler indicated that he had asked his staff to make recommendations regarding central clearing of Treasuries and Treasury repos.¹⁹ SEC staff apparently are well along in their efforts to respond to Chair Gensler's request. The SEC will soon be seeking public comment on options with respect to three sets of issues: (1) steps that the SEC might take to facilitate clearing of dealer-to-client trades, (2) potential enhancements to FICC's risk management policies and procedures, and (3) the public policy case and the appropriate scope of any mandate to centrally clear Treasuries or Treasury repos. FICC does not have access to the Federal Reserve's SRF.

Obviously, it is too soon to tell the extent to which the SEC ultimately will take steps consistent with the G30 recommendations with respect to clearing, but it seems to be committed to addressing these complex and important issues promptly, thoroughly, and methodically.

¹⁵ However, reasonable arguments have been made that clearing more trades through FICC would reduce rather than increase FICC's counterparty exposure to its members and, by making those exposures more transparent to FICC, would enable FICC to manage those exposures more effectively. See Depository Trust Company and Clearing Corporation 2021.

¹⁶ 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, and U.S. Commodity Futures Trading Commission 2021.

¹⁷ In addition, FICC has been designated a Systemically Important Financial Market Utility (SIFMU) under Title VIII of the Dodd-Frank Act, which gives the Federal Reserve certain limited authorities with respect to the oversight of FICC.

¹⁸ Gensler 2022.

¹⁹ Gensler 2021.

PRUDENTIAL REGULATION OF DEALERS

Recommendation 6: Banking regulators should review how market intermediation is treated in existing regulation, with a view to identifying provisions that could be modified to avoid disincentivizing market intermediation, without weakening overall resilience of the banking system. In particular, U.S. banking regulators should take steps to ensure that risk-insensitive leverage ratios function as backstops to risk-based capital requirements rather than constraints that bind frequently.

Recommendation 7: The SEC, in consultation with the Federal Reserve and the Treasury, should review the robustness of the prudential safeguards at broker-dealers (including interdealer brokers) in U.S. Treasury securities and Treasury repos that are not affiliated with banks (independent dealers).

Rationale: The G30 report concluded that, even if implementation of the report's recommendations results over time in the broadening and diversification of market intermediation, in the near term the liquidity of the Treasury markets under stress is likely to remain reliant on a small number of very large broker-dealer affiliates of U.S. global systemically important banks (GSIBs). In the aftermath of the global financial crisis, U.S. banking regulators have significantly strengthened the capital requirements applicable to these firms, which the crisis had revealed to be seriously inadequate. However, some elements of the new capital regime may be creating unnecessary and unintended disincentives to the conduct of relatively low-risk activities, including providing liquidity to the U.S. Treasury and Treasury repo markets. In particular, in large measure because of the massive expansion in recent years of the Federal Reserve's balance sheet (and the accompanying expansion of central bank balances on bank balance sheets), risk-insensitive leverage ratios (notably, the Supplemental Leverage Ratio [SLR]) have become the binding regulatory constraint on the allocation of capital by most of the banks whose dealer subsidiaries are the largest providers of

liquidity to the Treasury markets. Some combination of easing of leverage constraints and tightening of risk-based capital requirements could reduce these disincentives to Treasury market intermediation without weakening the overall resilience of the banking system.

The G30 report observed that as banks have reduced the capital allocated to Treasury market intermediation in recent years, other firms (notably PTFs) have stepped up their market-making activity. Furthermore, an overall goal of the G30 recommendations is to broaden and diversify the supply of market liquidity by removing impediments to market-making by broker-dealers not affiliated with banks. The report noted that these developments heightened the importance of the SEC's prudential requirements, which are the only such requirements applicable to such dealers.

Implementation Status: In April 2020, concerned that the SLR was contributing to dysfunction in the Treasury market and otherwise limiting banks' capacity to intermediate to the extent required by the COVID-19 pandemic, the Federal Reserve had allowed banks to deduct deposits at Federal Reserve Banks and holdings of Treasury securities from the denominator of the SLR on a temporary basis. A year later, the Federal Reserve allowed this temporary relief to expire but announced in a press release that it "will soon be inviting comment on several potential SLR modifications."²⁰ No such request for comment has yet been issued, although we understand that Fed staff are continuing to study potential SLR modifications. We see no evidence that the agencies are conducting a broad review of regulatory disincentives for market intermediation like that called for by the recommendation.

No fundamental review of prudential standards for independent broker-dealers currently is planned. However, as will be discussed below, the SEC has issued a proposal that, if adopted, would require PTFs and other firms conducting similar activities to register as broker-dealers. Furthermore, if trades executed on interdealer trading platforms intermediated by IDBs were required to be centrally cleared, as recommended by the G30, IDBs would no longer be involved in the settlement of trades, which would eliminate much of the concern about their prudential regulation as independent dealers.

²⁰ Federal Reserve 2021.

MARKET TRANSPARENCY

Recommendation 8: The TRACE reporting system should be expanded to capture all transactions in U.S. Treasury securities and Treasury repos, including those of commercial bank dealers and principal trading firms. Furthermore, subject to a cap on the disclosed size of trades, the data should be publicly disclosed in a manner similar to the way that data on corporate bond transactions are currently disclosed.

Recommendation 9: SEC Regulations ATS and SCI should be applied to all significant trading platforms for Treasury securities, including both interdealer and multidealer dealer-to-client platforms.

Rationale: Since 2017, Treasury transactions data have been collected by the Financial Industry Regulatory Authority (FINRA) from its broker-dealer members through its TRACE reporting system and shared with the SEC and the other regulatory authorities. However, those data were not comprehensive because they did not capture certain transactions involving banks and PTFs. Furthermore, TRACE does not collect data on Treasury repos. Perhaps most important, unlike TRACE data on trades of corporate bonds and other fixed-income securities, TRACE data on Treasury transactions are not disseminated to the public. The G30 report concluded that public dissemination of TRACE data would have several benefits, including facilitating competition among existing dealers, enabling additional dealers to compete to execute trades, and facilitating counterparty risk management, both bilaterally and by FICC. It concluded that concerns that the liquidity of markets for off-the-run issues could be harmed by public disclosure could be addressed effectively by capping the disseminated size of trades in such issues, as is done in public disclosures of TRACE data for other markets.

The G30 report observed that another important dimension of market transparency is with respect to the rules of trading platforms for Treasury securities, which

have been exempt from certain regulations (Regulations ATS and SCI) that apply to trading platforms for equities. In September 2020, the SEC had issued a proposal that would apply these requirements to the principal interdealer trading platforms but not to the principal multidealer dealer-to-client platforms, which use request for quote (RFQ) or streaming quote protocols. The G30 report essentially recommended that the proposal be broadened to apply regulations ATS and SCI to the latter trading platforms as well.

Implementation Status: The Federal Reserve and the SEC have taken steps toward capturing nearly all transactions in Treasury securities in TRACE. Last fall, the Federal Reserve finalized a rule that requires banks that are active in the Treasury market to report transactions to TRACE. In March 2022, the SEC proposed rules broadening the definition of a dealer that would require PTFs and firms conducting similar activities to register with the SEC as dealers. Such firms would be required to become members of a self-regulatory organization. If they choose to become a member of FINRA they would become subject to requirements to report their Treasury transactions to TRACE. The reporting of Treasury repos to TRACE does not seem to be under consideration. Instead, the authorities seem to be focused on developing a mechanism for them to gain access to information on bilateral repos that are not cleared, which they currently do not have. As yet, the authorities have taken no steps to publicly disseminate TRACE data on individual Treasury transactions. However, in a recent speech, SEC Chair Gary Gensler indicated that he thinks that, once reporting of TRACE data is broadened to include banks and PTFs, public dissemination would be appropriate.²¹ And the Treasury Department has stated that it intends to issue a request for information on the potential benefits and risks of specific steps that could be taken to provide additional transparency in the Treasury market.²²

In January 2022, the SEC proposed a new broader definition of “exchange” that would have the effect of covering the principal interdealer and multidealer-to-client platforms for Treasury securities and therefore require them to comply with Regulations ATS and SCI.

²¹ Gensler 2022.

²² U.S. Department of the Treasury 2021.

MARKET REGULATION

Recommendation 10: As a first step toward more vigorous oversight of the Treasury market, the Treasury, after consultation with the Federal Reserve, should lead an interagency study that identifies all exemptions of Treasury securities from U.S. securities laws, evaluates their rationales, and, where there is no clear and compelling rationale, recommends measures for applying those laws to Treasury securities. Thereafter, Treasury should prepare an annual report on Treasury market functioning.

Rationale: The G30 report observed that the U.S. Treasury markets have been exempted by law or regulation from many provisions of U.S. securities laws, with many of these exemptions dating to the 1930s, when the Treasury markets were smaller and less important. It recommended a study of those exemptions and rationales as a first step toward more vigorous oversight.

Implementation Status: There seems to be no enthusiasm for such a broad study. The regulatory authorities are focusing their resources on addressing the issues identified in the IAWG report, which align reasonably well with the issues identified in the G30 report, as discussed above.

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