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Murray C. Pozmanter
Managing Director
Head of Clearing Agency Services

55 Water Street
New York, NY 10041

TEL: (212) 855-7522
mpozmanter@dtcc.com
www.dtcc.com

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Via Submission through the Federal eRulemaking Portal (www.regulations.gov)

Re: Department of Treasury (Treasury) Notice Seeking Public Comment on the Evolution of the Treasury Market Structure (Treasury Notice)

Ladies and Gentlemen:

The Depository Trust & Clearing Corporation (DTCC)¹ appreciates the opportunity to provide our views on certain sections of the Treasury Notice. DTCC's wholly-owned subsidiary, the Fixed Income Clearing Corporation (FICC²), is a critical part of the U. S. Treasury market. Through its Government Securities Division, FICC offers a suite of services to support and facilitate the submission, comparison, risk management, netting and settlement of trades executed by its members in the U.S. Government securities market. FICC provides a guaranty of settlement of all compared trades and serves as the central counterparty for the settlement obligations it novates. FICC processes buy-sell transactions of U.S. Government securities, repurchase agreement (repo) transactions, including overnight, forward-start and term repo transactions, and GCF Repo® transactions. In 2015, the Government Securities Division average daily clearing volume was almost \$3 trillion. In addition, all 22 primary dealers are members of FICC.

DTCC is responding to the sections of the Treasury Notice referenced below.

¹ With over 40 years of experience, DTCC is the premier post-trade market infrastructure for the global financial services industry. From operating facilities, data centers and offices in 23 countries, DTCC, through its subsidiaries, automates, centralizes, and standardizes the post-trade processing of financial transactions, mitigating risk, increasing transparency and driving efficiency for thousands of broker/dealers, custodian banks and asset managers worldwide. User owned and industry governed, the firm simplifies the complexities of clearing, settlement, asset servicing, data management and information services across asset classes, bringing increased security and soundness to the financial markets. In 2015, DTCC's subsidiaries processed securities transactions valued at more than US\$1.5 quadrillion. Its depository provides custody and asset servicing for securities issues from more than 130 countries and territories valued at US\$45 trillion. DTCC's global trade repository processes approximately \$300 million of submissions per week.

² FICC is a clearing agency registered with the Securities and Exchange Commission. In July 2012, FICC was designated as a systemically important financial market utility under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. FICC operates two Divisions, the Government Securities Division and the Mortgage-Backed Securities Division. FICC's participation in the U.S. Treasury market occurs through FICC's Government Securities Division.

General Observations of Recent Trends in Treasury Market Structure

First and foremost, the U.S. Treasury market plays the important role of financing the functions of the U.S. government. The U.S. Treasury market is also critical to the global capital markets and serves as the baseline for determining global risk premiums. Measured by outstanding issuance, it is almost twice the size of the U.S. equity market and twenty times the size of the U.S. corporate bond market. In order to continue serving these two important roles, the U.S. Treasury market must function as efficiently as possible, which in part means that all sell and buy orders be matched to the extent possible, and price formation is transparent and fair. Efficient market functioning is becoming increasingly challenged, however, as trading models and platforms continue to evolve, rendering the current Treasury market structure more and more fragmented with varied execution speeds among trading venues. The over-the-counter (OTC) and exchanged-traded markets support different trading processes, and these heavily influence where and how orders are executed. Additionally, these markets have different regulatory supervision regimes and impose separate rules.

FICC has also observed that fixed-income and repo trading volumes have declined over the last several years. One of the factors contributing to this decline most often cited by academics and market participants is the enhanced bank capital rules implemented by global prudential supervisors after the financial crisis. In addition, the available secondary market for U.S. Treasuries continues to shrink due to foreign purchases, increases in real money investments, and government purchases.

Another trend is that the proportion of principal-to-principal trading by bank dealers in U.S. Treasury cash markets has become smaller. In this market structure, the bank dealer as market-maker is compensated for best execution and warehousing any residual risk. With current return on capital below historical levels, banks have focused on reducing expenses and capital allocation. The banks internalize customer orders to the best of their ability but have less capacity to do so for the foregoing reasons, compelling them to take the orders that they do not wish to fill to the interdealer market. This has created greater demand for use of the interdealer market to mitigate residual risk, which in turn has led to a move towards electronic trading and other opportunities that will reduce the balance-sheet impact of the business.

The speed, capacity and sophistication of the trading functions that are available to market participants have improved dramatically. These factors are contributing to a market where principal trading firms (PTFs) are increasing their influence and possibly creating imbalances in demand and execution costs.

PTFs play an important role in price discovery. These non-bank liquidity providers have increased their market share, and their activity is typically focused on more liquid, on-the-run Treasuries. Additionally and unlike the trades of cash securities between bank dealers, PTFs' trading activity typically is not cleared by a central counterparty (CCP), such as FICC. This results in bifurcation across the Treasury market, with a growing percentage of the market bilaterally cleared by PTFs, while much of the bank-dealer trading activity continues to clear at FICC. The preference of PTFs to bilaterally clear their cash Treasuries is driven mainly by cost considerations as well as a lack of legal mandate to clear through a CCP.

DTCC Response to Questions 1.4 through 1.7 in Part I (Further study of the evolution of the U.S. Treasury market and the implications for market structure and liquidity) and Question 2.1, 2.5 and 2.6 in Part II (Continued monitoring of trading and risk management practices across the U.S. Treasury market and a review of the current regulatory requirements applicable to the government securities market and its participants)

Part I of the Treasury Notice sought comment on whether the public should anticipate significant changes in the structure of the U.S. Treasury market absent further regulatory changes. Given continuing regulatory efforts to shore up supervision of bank dealers (e.g., many enhanced capital requirements for bank dealers have not been fully implemented), as well as technological advances that permit more and more market entrants to participate in the Treasury market, it would seem more likely than not that the observed trends described in the previous section of this comment will continue absent regulatory intervention.

While there are some benefits to having new liquidity-providing entrants to the Treasury market such as PTFs, there are risks as well. For instance, the fact that PTFs do not clear their cash trades through a CCP leaves market participants exposed to bespoke risk margining and reduced transparency. This could increase the likelihood of the failure of a non-CCP member impacting a dealer who is a member in the CCP if that failure is large enough and the exposure is not appropriately margined. Additionally, the default of a CCP member would impact not just the CCP but the other CCP members as well. It would be advisable, therefore, to consider imposing the same cleared market structure on all participants within that market in order to more broadly achieve the benefits brought by a CCP.

Implementing a clearing function for the processing of eligible transactions that are currently not centrally cleared will play a significant role in promoting the resilience, stability and transparency of the Treasury market. FICC believes that central clearing helps to address several of the public-policy concerns that have been raised in the Joint Staff Report (cited in the Treasury Notice) by providing the following benefits, and may reduce risks from automated trading:

- Decreased settlement and operational risk, as more transactions for a greater number of counterparties would be netted and subject to guaranteed settlement, novation and independent risk management.
- More transparency and consistency in the risk surveillance and margining that would support regular intraday margin collections, timely risk identification, and coordination across cash/futures markets.
- More efficient use of collateral as the central counterparty would have a more accurate view of the total exposure of each market participant, and minimize “fire sale” risk by providing the ability to centralize and control the liquidation of a failed counterparty, which in turn could reduce potential market disruption from a dealer default.
- Existing CCP members may also be eligible for balance sheet offset in connection with PTF trades, thereby alleviating constraints on their balance sheets and increasing liquidity in the financial system.

Because individual products within the Treasury complex tend to trade at different speeds and through different market structures, the benefits and risks can also vary across individual products. Within the Treasury market, 60% of the dealer to client trading volume occurs in the on-the-run securities despite only being less than 2% of the outstanding US Treasury market value. Since the off-the-run securities are less actively traded, PTFs are not typical liquidity providers in these bonds. While this demand for on-the-run bonds allows the Treasury to borrow

at lower costs, it creates liquidity premiums between on- and off-the run securities. A centrally cleared requirement may provide incentives for PFTs to support the broader range of securities that in turn will expand liquidity across the full Treasury issuance and reduce liquidity premiums which will reinforce Treasury's efforts to raise debt as cost effectively as possible.

Additionally, there is a tight link between funding liquidity in repo markets and market liquidity in cash and futures markets. Financial institutions rely on the U.S. Treasury repo market to finance their balance sheets and facilitate customer transactions in Treasury and other types of securities. A healthy, liquid repo market therefore is essential to the overall health of the market.

FICC believes that a robust tri-party repo market is critical to the funding markets. Treasury repo markets also have been undergoing structural changes which have reduced capacity. All major dealers are now subject to the central bank stress tests and Basel II rules that have enhanced capital and liquidity requirements for repo transactions. The demand for high quality liquid assets (HQLA) has reduced the availability of these securities in the repo market. Additionally, due to modifications to the tri-party settlement process and changes in dealer practices, the amount of intraday credit extended by the settlement banks has been significantly curtailed.

Consequently, DTCC believes that the U.S. Treasury repo market is less efficient than it could be, and that an expanded, cleared market structure would bring more efficiency. Again, with the appropriate regulatory approval, such a market structure would incentivize participation by a broader range of participants willing to lend cash for securities, thus promoting liquidity. The same risk-reducing and transparency-enhancing features of a CCP described above would be brought to bear on the repo marketplace as well.

Part II of the Treasury Notice requested comments about additional risk controls that could be recommended for the Treasury cash and future markets which are closely linked. Market participants in the spot market use futures to protect against interest-rate uncertainty. Since futures contracts are used to hedge and speculate on interest-rate movements, the futures prices provide an indication of potential interest-rate variability. Many market participants perform liquidity transformation across cash and futures markets.

As mentioned, the U.S. Treasury market as a whole operates with significant differences in speed of price discovery depending on the trading venue involved, with approximately half the market activity on electronic trading platforms. Given its stature in the global markets as a risk-free benchmark, the U.S. Treasury market must function with limited asymmetric information. It is clear that trading practices and market linkages continue to become more complex and constantly evolve. New technology and greater speed will lead to new methods of trading. As the Joint Staff Report highlights, there are concerns with the changing nature of liquidity, which could lead to potential additional information asymmetries that could then lead to adverse selection as participants are challenged to interpret market data and market behavior.

The trading platforms and executions have also advanced with technology. We previously saw large trades executed as one or possibly several market buy trades, and now algorithms split that trade into a multitude of limit orders placed in layers, with orders cancelled and updated as trading progresses. This makes it critical to evaluate and risk manage these trades in real-time, aggregated and across markets.

If all Treasury cash and futures transactions are centrally cleared, the CCPs will have at least as good, if not better, trade and pricing data than that in possession of its members. This would

improve the robustness and comprehensiveness of intraday surveillance and margining that it is critical to effectively risk manage these high volume executions and limit systemic risks across the entire Treasury market. This also allows for more reliance on intraday trading/pricing data and better calibration of risk margining models. Ultimately, central clearing would limit intraday risk and potential market asymmetries that could develop with these new liquidity providers and their more complex trading strategies.

Again, for the reasons articulated above, implementing a clearing function for the processing of eligible transactions that are currently not centrally cleared will play a significant role in promoting the resilience, stability and transparency of the Treasury market.

DTCC Response to Part III (An assessment of the data available to the official sector on U.S. Treasury cash securities market and Part IV (An assessment of the data available to the public on U.S. Treasury cash securities markets)

It is important that participants have a view into order and transaction data in the U. S. Treasury market. DTCC believes that there is value in a centralized trading reporting repository. It can increase market transparency by providing public and regulatory reporting to ensure that risk can be viewed from a central vantage point through a global repository.

As an operator of trade repositories, we have seen a reduction in operational risk and increases in efficiency by automating and centralizing the maintenance of position data and supporting a range of post-trade processing requirements from a single location. Other benefits include accuracy and comprehensiveness based on the most current position records, facilitation of tracking of payment flows between firms and efficiency of portfolio management tools and processes.

DTCC's experience has shown that regulators and supervisors value information regarding (inter alia):

- The size and structure of the market;
- Positions and exposures of systemically important organizations;
- Institutions and their contagion impacts;
- Concentrations in exposures in the markets;
- Issues of potential market abuse, including understanding the impact of non-domestic transactions.

DTCC believes that the market would benefit from transparency into pre-trade and post-trade data as both provide insight into prices and execution, and the beneficial functions of trade repositories are as follows:

- Position and pricing information (including timestamps)
- Data validation
- Data cleansing
- Providing market transparency by thorough public reporting of aggregated trade data
- Providing market and firm position transparency to regulators through regulatory reporting
- Enhancing the transparency of deal-books for participant firms.

* * *

DTCC appreciates the opportunity to respond to the foregoing issues raised by the Treasury Notice. Should you wish to discuss this response further, please contact the undersigned at 212-855-7522.

Sincerely yours,

A handwritten signature in black ink, appearing to be "JD" followed by a horizontal flourish.