

US Treasury market needs to enter modern age

Series of reforms needed to improve trading in the world's most important asset class



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Since its establishment in 1790, the US Treasuries market has fuelled America's emergence as an economic superpower.

Given its size and centrality to the global financial system, one would expect the US Treasuries market to have a modern structure. Yet the reality is that it has failed to keep pace with other financial markets. Recent shocks to the Treasuries market, including the pandemic-driven volatility of March 2020, highlight the need for structural reform. A wholesale rewrite is not required but a series of targeted changes could bring it more into the modern age.

First, we should implement robust public reporting of trades in US Treasuries. Public trade reporting is a key source of transparency and a hallmark of virtually every major market, including US equities, options, futures, corporate bonds, municipal bonds and many derivatives. It is remarkable that there is scant publicly available information on US Treasury securities trades. While financial companies can afford to subscribe to private data feeds, even the best of these may capture only up to half of Treasury trades. As a result, the Treasury market operates with significantly impaired post-trade transparency.

Enhancing public access to complete and timely trade data would strengthen competition, improve liquidity, aid in risk management, reduce transaction costs and increase investor confidence. It would also help investors better understand the factors driving changes to price and liquidity conditions before crises develop. Public reporting, especially in real time, has been shown to reduce systemic risk and improve market resilience.

Implementing real-time trade reporting would be straightforward. The infrastructure necessary has been in place for years. With just one small step, the transaction data on Treasuries that the Financial Industry Regulatory Authority already collects through its Trace system could be publicly disseminated, just as it is for corporate bonds, at no additional cost or burden.

Second, improving trading venue oversight should be a priority. All trading venues for Treasuries should be required to register with the Securities and Exchange Commission. This would provide transparency in several areas, including rule books, governance,

access criteria, operations, services and fees. Trading venues should also be subject to non-discriminatory access requirements that put all market participants on a level playing field.

Third, trading venues for Treasury securities should adopt safeguards against new types of risk, including those related to technological errors, to increase operational resilience. While the growth of electronic trading has significantly increased liquidity, it also comes with inherent risks that should be addressed responsibly, such as the possibility of erroneous order placement. Equity markets, for example, have widely adopted risk-control measures that can prevent or cancel errant orders.

Finally, as the Treasury market has grown and volumes have soared, the risks of counterparty default have increased. Settlement failures dramatically rose during the market turmoil of March 2020.

Central clearing has long been instrumental in reducing counterparty credit risk in other advanced financial markets. Yet the Treasury market lags behind its peers and has not imposed any broad-based clearing requirements for cash transactions or “repo” short-term borrowing trades. Although a small portion of the interdealer market is cleared through the Fixed Income Clearing Corporation, access to clearing has historically been limited to the largest financial institutions.

Implementing widespread central clearing in the Treasury market would decrease the market’s current reliance on bank balance sheets, facilitate further innovations in trading and allow more capital to flow to other parts of the market.

More specifically, placing a clearing house between trading parties can ensure proper collateral and settlement protocols that help reduce systemic risk. Clearing houses also allow trading positions between their members to be offset against each other, freeing up capital so that buying and selling can continue efficiently even during periods of heightened volume and volatility.

In sum, we can ensure that our Treasury market is transparent, liquid, efficient and resilient through a few overdue reforms that have proven effective in other advanced financial markets. Future generations of Americans deserve nothing less.