ENHANCING THE RESILIENCE OF THE U.S. TREASURY MARKET: 2024 STAFF PROGRESS REPORT

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

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This is a report of staff findings from the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the U.S. Securities and Exchange Commission, and the U.S. Commodity Futures Trading Commission. The report represents only the views of staff, and the organizations listed above have expressed no view regarding the analysis, findings, or conclusions contained herein.

Section 1: Introduction

The Treasury market remains the deepest and most liquid market in the world and a central component of the financial system. In response to evolution in the market as well as several episodes of abrupt deterioration in market functioning, the relevant authorities in the Treasury market began an extensive program of analysis and policymaking in 2021 to help ensure that the market continues to reliably fulfill its vital role. The authorities provided updates on those efforts in Staff Progress Reports issued in 2021, 2022, and 2023.[1] This report describes the authorities' progress in support of these objectives over the past year and outlines policy areas where further consideration is ongoing.

The relevant authorities in the Treasury market collaborate to ensure effective surveillance and coordinated policymaking. The views presented here are those of the Inter-Agency Working Group on Treasury Market Surveillance (IAWG), which consists of staff from the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York (FRBNY), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC).[2]

As discussed in the Staff Progress Report issued in 2021, the authorities have three primary objectives in the Treasury market:

> First, as the issuer of Treasury securities, the Treasury Department seeks to finance the federal government at the lowest cost to the taxpayer over time. Second, the authorities aim for the Treasury market to support the broader financial system. The market does so by serving as a source of safe and liquid assets that support the efficient, stable flow of capital and credit to households and businesses, and by establishing a benchmark credit-risk-free yield curve. Third, the Federal Reserve implements monetary policy partly through transactions in the Treasury market. More broadly, the smooth operation of the Treasury market is important to the transmission of the stance of monetary policy to broader financial conditions and the U.S. economy.

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[1] 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, and U.S. Commodity Futures Trading Commission, "Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report," November 8, 2021, available at https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf; 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, "Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report," November 10, 2022, available at https://home.treasury.gov/system/files/136/2022-IAWG-Treasury-Report.pdf; 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, "Enhancing the Resilience of the U.S. Treasury Market: 2023 Staff Progress Report," November 6, 2023, available at https://home.treasury.gov/system/files/136/20231106_IAWG_report.pdf.

[2] The Treasury Department, SEC, and Federal Reserve Board formed the IAWG in 1992 to improve monitoring and surveillance and strengthen interagency coordination with respect to the Treasury markets following the Salomon Brothers auction bidding scandal. See U.S. Department of the Treasury, Securities and Exchange Commission, and Board of Governors of the Federal Reserve System, 1992, "Joint Report on the Government Securities Market," U.S. Government Printing Office, January 22, available at https://home.treasury.gov/system/files/276/joint-report-on-the-government-securities-Market-1992.pdf. Today, the IAWG consists of staff from the Treasury Department, SEC, Federal Reserve Board, FRBNY, and CFTC.

The IAWG's assessment of policy options is grounded in recent experience with Treasury market stresses and in principles that the IAWG staffs have proposed for public policy in the Treasury market. These principles, detailed in the 2021 Staff Progress Report, are:

1. Resilient and elastic liquidity;
2. Transparency that fosters public confidence, fair trading, and a liquid market;
3. Prices that reflect prevailing and expected economic and financial conditions;
4. Economic integration across cash, funding and derivatives markets;
5. Financing that does not pose a significant threat to financial stability; and
6. Infrastructure that operates effectively and efficiently.

This report describes the authorities' progress in support of the official sector's objectives over the past year. Notable accomplishments included:

- The SEC's adoption of rules to facilitate the clearing of additional Treasury securities transactions;
- The Treasury Department's launch of a buyback program to bolster Treasury market liquidity as well as enhance Treasury's own cash management capabilities;
- The SEC's adoption of new rules to require registration by market participants who act as dealers;
- The commencement of the dissemination of data on individual transactions in on-the-run nominal coupon Treasury securities; and
- The finalization by Treasury's Office of Financial Research (OFR) of a rule to require reporting of non-centrally cleared bilateral repurchase agreements (repos).

Section 2: Progress over the past year

The IAWG's work in recent years has been structured in five workstreams: improving resilience of market intermediation, improving data quality and availability, evaluating expanded central clearing, enhancing trading venue transparency and oversight, and examining effects of leverage and fund liquidity risk management. IAWG member organizations have continued their work to promote each of these workstreams over the past year.

A. Improving the resilience of market intermediation

IAWG principles call for Treasury markets to "have the capacity to support robust primary issuance and secondary trading across a wide range of economic and financial circumstances." In the past year, IAWG member institutions continued to work to enhance the resilience of intermediation. These efforts included the launch of a buyback program for Treasury securities, the adoption of changes to dealer registration requirements, and continued study of market structure and liquidity in the off-the-run segment.

Treasury buyback program

In May 2024, the Treasury Department launched a buyback program with two objectives: bolstering secondary market liquidity and enhancing Treasury's own cash management capabilities.

In support of the first objective, bolstering liquidity, the program provides market participants with an opportunity to sell off-the-run, less-frequently-traded nominal coupon securities and Treasury Inflation-Protected Securities (TIPS) back to the Treasury. Since the end of May, Treasury has conducted weekly liquidity buyback operations, rotating through nine buckets defined by tenor and security type. Although the size of Treasury's cumulative purchases so far is small relative to the size of the market, Treasury expects that liquidity improvements will accumulate over time through three channels. First, dealers should feel more confident making markets in off-the-run securities, as they will have Treasury as a regular and predictable buyer. Second, Treasury buyback operations are expected to serve as a focal point for trading activity, increasing market liquidity around buyback events. And third, dealers may use buyback operations to free up balance sheet that they could then dedicate to additional market making. These developments should foster resilient and elastic liquidity in the Treasury cash market, in alignment with the IAWG's principles. Feedback from primary dealers has provided early indications that Treasury's buyback operations are supporting off-the-run liquidity.

The program also includes cash management buybacks that aim to support Treasury's management of bill auction sizes and the Treasury General Account (TGA). These buybacks, which began in September 2024, will allow Treasury debt managers to deploy large cash inflows around tax payment dates both to reduce the magnitude of future coupon maturity outflows and to avoid excessive volatility in the supply of Treasury bills. Two key differences between liquidity support and cash management buybacks are the maturity sector within which Treasury operates and the frequency of operations. Unlike liquidity support buybacks, Treasury's cash management buybacks are restricted to the four-week to two-year maturity sector and may vary in size throughout the calendar year based on the strength of Treasury's fiscal flows.

Treasury's quarterly refunding documents provided further details on buyback scheduling, purchase limits, publication of announcements and results, and CUSIP eligibility.[3] In the coming year, Treasury will continue to conduct buyback operations and may consider incremental updates to the program's design as it gains further experience.

SEC dealer registration requirement

In February 2024, the SEC adopted new rules 3a5-4 and 3a44-2 under the Securities Exchange Act that require market participants who take on significant liquidity-providing roles to register with the SEC, become members of a self-regulatory organization, and comply with federal securities laws and regulatory obligations.[4] The Commission stated that registration "will support market stability and resiliency and protect investors by promoting the financial responsibility and operational integrity of significant liquidity providers that are acting as dealers in the securities markets."[5]

The new rules establish two parallel, non-exclusive standards to identify persons whose liquidity-providing activities constitute dealer activities. Specifically, a person will be determined to be engaged in a regular pattern of providing liquidity to other market participants "as part of a regular business" by either (1) regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security, and that is communicated and represented in a way that makes it accessible to other market participants; or (2) earning revenue primarily from capturing bid-ask spreads, buying at the bid and selling at the offer, or capturing any incentives offered by trading venues to liquidity-supplying trading interest. The new rules exclude investment companies registered under the Investment Company Act of 1940; central banks, sovereign entities, and international financial institutions (as defined in the rules); and any person that has or controls total assets of less than $50 million.

The new rules make clear that no presumption shall arise that a person is not a dealer or government securities dealer solely because that person does not engage in the activities identified in the final rules. Existing SEC interpretations and precedent relating to dealer jurisprudence will continue to apply.

The SEC had initially proposed new rules on dealer registration in 2022.[6] In finalizing the adoption of the new rules, the SEC made a number of adjustments to the proposed rules in response to public feedback, including: (1) eliminating the first proposed qualitative factor that would have captured roughly comparable purchases and sales of the same or similar securities in a day; (2) eliminating the quantitative standard that would have established a bright-line test

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[3] See U.S. Department of the Treasury, "Regular Treasury Buyback Program Details," April 2024, slide presentation, available at: https://home.treasury.gov/system/files/221/TreasurySupplementalQ22024.pdf.
[4] See Securities and Exchange Commission, "Further Definition of 'As a Part of a Regular Business' in the Definition of Dealer and Government Securities Dealer in Connection With Certain Liquidity Providers" Federal Register 89, No. 41 (Feb. 29, 2024): 14938-15010, available at: https://www.federalregister.gov/documents/2024/02/29/2024-02837/further-definition-of-as-a-part-of-a-regular-business-in-the-definition-of-dealer-and-government.
[5] See id. at 14939.
[6] See Securities and Exchange Commission, "Further Definition of 'As a Part of a Regular Business' in the Definition of Dealer and Government Securities Dealer" Federal Register 87, No. 74 (April 18, 2022): 23054-23106, available at: https://www.federalregister.gov/documents/2022/04/18/2022-06960/further-definition-of-as-a-part-of-a-regular-business-in-the-definition-of-dealer-and-government.

under which persons engaging in certain specified levels of activity in the U.S. Treasury market would be deemed to be buying and selling government securities "as a part of a regular business," regardless of whether they met any of the qualitative standards; and (3) revising the definition of "own account" to eliminate the proposed aggregation provision and instead include an anti-evasion provision intended to deter the establishment of multiple legal entities or accounts to evade appropriate regulation.

The rules went into effect on April 29, 2024. Persons will be required to comply with the rules as of April 29, 2025.

Analysis of off-the-run market structure and liquidity

As part of their examination of how potential changes in Treasury market structure could enhance the resilience of intermediation, IAWG staff continued the study of the off-the-run market discussed in the 2023 Staff Progress Report.

Staff have studied the official-sector Treasury transaction-level data from the Trade Reporting and Compliance Engine (TRACE) of the Financial Industry Regulatory Authority (FINRA) to empirically describe trading activity and produce liquidity measures for off-the-run securities. The analysis examines how trading activity varies by level of seasoning, tenor, and proximity to cheapest-to-deliver securities for Treasury futures contracts. Staff also gathered market intelligence on the off-the-run market by conducting structured outreach to a cross-section of market participants, including dealers, hedge funds, principal trading firms, foreign investors, and asset managers.

A working paper leveraging IAWG staff research is expected to be released.

B. Improving data quality and availability

To support the IAWG staffs' principle of "transparency that fosters public confidence, fair trading and a liquid market," the official sector is working to improve the quality and coverage of data on Treasury market transactions and positions. These actions encompass providing additional public transparency as well as collecting additional data to help the official sector understand market conditions. As described below, IAWG member institutions continue to build on past efforts to collect better information and to disclose more timely and granular information to the public on cash market transactions.

End-of-day dissemination of on-the-run transactions

On March 25, 2024, FINRA began disseminating data on individual transactions in on-the-run nominal coupon Treasury securities at the end of each trading day. Published trade sizes are capped at $250 million for 2-, 3-, and 5-year notes; $150 million for 7- and 10-year notes; and $50 million for 20- and 30-year bonds. In addition to trade size, the end-of-day transaction data includes information regarding the security traded, price, counterparty type (i.e., dealer, customer, affiliate, or alternative trading system), and other trade modifiers and indicators. The disseminated data does not identify individual counterparties to the trade.

Transactions included in the end-of-day data represent more than half of all trading volume across Treasury securities and approximately 75 percent of trading volume in fixed-rate nominal coupon securities. The end-of-day dissemination is in addition to existing daily and monthly reports on aggregate transaction volume.

On April 1, 2024, FINRA also began releasing a historical data set for on-the-run nominal coupon transactions, on a six-month delayed basis and with uncapped transaction sizes.

Non-centrally cleared bilateral repo transaction reporting

In May 2024, OFR finalized a rule requiring daily reporting of non-centrally cleared bilateral repo (NCCBR) transactions by certain brokers, dealers, and other financial companies with large exposures. Covered brokers and dealers will be required to report data starting in early December 2024.

This collection will fill a critical data gap. NCCBR is the last U.S. repo market segment lacking a transaction-level data source, and NCCBR transactions currently comprise the majority of repo activity by several key categories of institutions, such as primary dealers and hedge funds. The new data will supplement transaction-level information already available to the official sector on the triparty and centrally cleared market segments. By providing insight into potential financial stability risks, the NCCBR data collection will support the work of the Financial Stability Oversight Council (FSOC) and its member agencies.[7]

Updates to the Weekly Report of Dealer Financing and Fails (FR 2004C)

In July 2024, the Federal Reserve Board adopted an extension of its Government Securities Dealer Reports. In this extension, the Board updated its Weekly Report of Dealer Financing and Fails (FR 2004C) to list sponsored general collateral repo transactions separately from traditional triparty repo transactions. In a sponsored repo, one participant is a sponsored member of the Fixed Income Clearing Corporation (FICC) whose obligations to FICC are guaranteed by another firm known as a sponsoring member. Sponsored general collateral repo is sponsored repo that settles within the triparty repo infrastructure while being centrally cleared by FICC. The update to the FR 2004C form will complement other sources of data on the centrally cleared repo market, including the FR 2004 data collected on the centrally cleared bilateral repo market and the OFR's centrally cleared repo data collection.[8]

Form PF improvements finalized

In February 2024, the SEC and the CFTC jointly adopted changes to Form PF, designed to improve the FSOC's ability to monitor systemic risk as well as bolster the SEC's oversight of private fund advisers and its investor-protection efforts.[9] The amendments will enhance reporting

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[7] For more information on the OFR's Centrally Cleared Repo data collection, see Office of Financial Research, "Centrally Cleared Repo Data Collection," available at: https://www.financialresearch.gov/data/collections/cleared-repo-data/.

[8] For more information on the FR 2004 data collection, see Board of Governors of the Federal Reserve System, "Instructions for the Preparation of Government Securities Dealer Reports," available at: https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=978610fa-a9ee-4a6c-ac90-8055546b77ea.

[9] See Commodity Futures Trading Commission and Securities and Exchange Commission, "Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers," Federal Register 89, No. 49 (March 12, 2024), 17984-18161, available at: https://www.federalregister.gov/documents/2024/03/12/2024-03473/form-pf-reporting-requirements-for-all-filers-and-large-hedge-fund-advisers.

by large hedge fund advisers regarding qualifying hedge funds to provide better insight into the operations and strategies of these funds and their advisers and to improve data quality and comparability. Among other matters, the changes include improvements in the reporting of investment exposures and enhanced differentiation between positions in the cash and derivatives markets for Treasury securities. The compliance date for these amendments is in March 2025.

C. Evaluating expanded central clearing

The IAWG staffs' principles emphasize the value of "well-designed and well-managed infrastructure" in the Treasury market. That infrastructure importantly includes the institutions and processes for clearing and settling Treasury transactions. Over the past year, the SEC adopted rules to expand the scope of central clearing in the Treasury cash and repo markets and to enhance risk management at central counterparties in these markets, and market participants have begun taking steps to respond to the new rules.

Adoption of SEC rules related to the clearing of Treasury securities transactions

The SEC adopted rules in December 2023 to enhance risk management practices for central counterparties in the Treasury market and facilitate additional clearing of Treasury securities transactions. The goals of the expansion of central clearing include reducing counterparty, operational, and liquidity risks; enhancing market efficiency; and increasing regulatory visibility into the market. According to an industry survey, market participants expect more than $4 trillion of additional daily activity in the Treasury market will be centrally cleared as a result of the SEC rules.[10]

As discussed in the 2023 Staff Progress Report, in September 2022, the SEC proposed to amend the standards applicable to covered clearing agencies (CCAs) providing central counterparty services for Treasury securities to require that such CCAs have written policies and procedures reasonably designed to require that every direct participant of a CCA submit for clearance and settlement all eligible secondary market transactions in Treasury securities to which it is a counterparty.[11] In December 2023, the SEC adopted the amendments largely as proposed, with certain modifications.[12] As adopted, the eligible secondary market transactions subject to the clearing requirement include:

- All repos and reverse repos collateralized by U.S. Treasury securities to which a direct participant of a CCA is a counterparty;
- All purchases and sales of U.S. Treasury securities by direct participants who are providing certain types of services (that is, bringing together multiple buyers and

[10] See Depository Trust & Clearing Corporation press release, June 4, 2024, available at: https://www.dtcc.com/news/2024/june/04/ficc-treasury-clearing-activity-expected-to-increase-by-over-us$4-trillion-daily.
[11] See Securities and Exchange Commission, 2022, "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," proposed rule, available at: https://www.sec.gov/rules/proposed/2022/34-95763.pdf.
[12] See Securities and Exchange Commission, 2023, "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," adopted rule, available at: https://www.sec.gov/files/rules/final/2023/34-99149.pdf.

sellers using a trading facility such as a limit order book, and being a counterparty to both the buyer and seller in two separate transactions); and

- All purchases and sales of U.S. Treasury securities between a direct participant and a registered broker-dealer or a government securities dealer or broker.

As adopted, eligible secondary market transactions do not include trades in which one counterparty is a central bank, a sovereign entity, an international financial institution, or a natural person. In addition, after considering the public comments, the SEC excluded from the final rule certain repos, i.e., those between a direct participant of a CCA and either a state or local government or another clearing organization, or those that are the direct participants' inter-affiliate transactions.

As proposed, eligible secondary market transactions also included cash transactions in Treasuries between a CCA's direct participants and hedge funds or leveraged accounts. However, the SEC did not adopt that requirement in light of questions raised by commenters that merit further consideration. Repos between hedge funds and a CCA's direct participants are still required to be centrally cleared, thereby addressing many of the risks posed by hedge funds' repo activity in the Treasury market. The SEC will continue to evaluate the issues raised to determine whether any further action is appropriate with respect to transactions in the cash market.

The adopted amendments also require CCAs to have policies and procedures to calculate, collect, and hold margin for a direct participant's proprietary positions separately from margin posted by the direct participant's customers. In addition, the amendment to Rule 15c3-3a under the Securities Exchange Act permits margin required and on deposit at a CCA for Treasury securities to be included as a debit item in the customer reserve formula, subject to certain conditions designed to ensure maximum protection of customers' assets. This new debit item will offset credit items in the Rule 15c3-3a formula and, thereby, free up resources that could be used to meet the CCA margin requirements in lieu of broker-dealers' own cash and securities.

The amendments regarding expanded access to clearance and settlement services, improvements to CCAs' risk management practices, and protection of customer assets have a compliance date of March 31, 2025. Compliance by the CCAs' direct participants with the requirement to clear eligible secondary market transactions is required by December 31, 2025, and June 30, 2026, respectively, for cash and repo transactions.

At present, FICC is the only CCA covered under the Treasury clearing rules. However, other clearing organizations have expressed interest in providing central clearing services in the U.S. Treasury market.[13] SEC staff is currently engaging with these organizations.

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[13] See Nikou Asgari and Jennifer Hughes, "CME Group bids to enter US Treasury clearing business," *Financial Times*, March 12, 2024, available at: https://www.ft.com/content/4693d21d-b3dd-43a5-8fec-4b898fc2ac57; Carolina Mandl and Davide Barbuscia, March 13, 2024, "LCH looking at clearing US Treasuries, competition set to increase," Reuters, available at: https://www.reuters.com/business/london-clearing-house-says-looking-clearing-us-treasuries-2024-03-13/; ICE press release, June 24, 2024, "ICE to Launch Treasury Clearing Service to Increase Transparency and Enhance Resilience in the U.S. Treasury Market," available at: https://ir.theice.com/press/news-details/2024/ICE-to-Launch-Treasury-Clearing-Service-to-Increase-Transparency-and-Enhance-Resilience-in-the-U.S.-Treasury-Market/default.aspx.

FICC has filed with the SEC three sets of proposed changes to its Government Securities Division Rulebook aimed at implementing the SEC amendments to CCA standards.[14] The proposed changes relate to access models; the calculation, collection and holding of margin for proprietary and indirect participant transactions; and requirements for direct participants to submit eligible secondary market transactions for central clearing. SEC staff is reviewing each proposal and the associated public comments.[15]

D. Enhanced trading venue transparency and oversight

Trading venues are another important form of market infrastructure whose efficiency and effectiveness influence the ability to achieve the authorities' goals for the Treasury market. Effective oversight of trading venues can help ensure not only that these platforms facilitate transactions efficiently but also that they are reliable and resilient and that they foster fair trading and public confidence in the market, among other goals.

As discussed in more detail in prior Staff Progress Reports, in 2020, the SEC proposed amendments to Regulation ATS and Regulation SCI to apply these regulations to Alternative Trading Systems (ATSs) that trade in and enter into repos collateralized by U.S. government securities.[16] In 2022, the SEC re-proposed the 2020 amendments and proposed to amend an SEC rule to include within the definition of "exchange" marketplaces that offer the use of non-firm trading interest and communication protocols to bring together buyers and sellers of securities.[17] In April 2023, the SEC reopened the comment period on the 2022 proposal to amend the

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[14] For more detail on each of these filings, see Securities and Exchange Commission, Release No. 34-99817, File No. SR-FICC-2024-005, available at https://www.sec.gov/files/rules/sro/ficc/2024/34-99817.pdf; Securities and Exchange Commission, Release No. 34-99805, File No. SR-FICC-2024-006, available at https://www.sec.gov/files/rules/sro/ficc/2024/34-99805.pdf; Securities and Exchange Commission, Release Nos. 34-99844 and 34-99845, File Nos. SR-FICC-2024-007 and SR-FICC-2024-802, available at https://www.sec.gov/files/rules/sro/ficc/2024/34-99844.pdf and https://www.sec.gov/files/rules/sro/ficc/2024/34-99845.pdf, respectively; and Securities and Exchange Commission, Release No. 34-100417, File No. SR-FICC-2024-009, available at https://www.sec.gov/files/rules/sro/ficc/2024/34-100417.pdf.

[15] See public comment files at https://www.sec.gov/comments/sr-ficc-2024-005/srficc2024005.htm, https://www.sec.gov/comments/sr-ficc-2024-006/srficc2024006.htm, https://www.sec.gov/comments/sr-ficc-2024-007/srficc2024007.htm, https://www.sec.gov/comments/sr-ficc-2024-802/srficc2024802.htm, and https://www.sec.gov/comments/sr-ficc-2024-009/srficc2024009.htm.

[16] See Securities and Exchange Commission, "Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets," Federal Register 85, No. 251 (December 31, 2020): 87106-87253, available at: https://www.federalregister.gov/documents/2020/12/31/2020-21781/regulation-ats-for-atss-that-trade-us-government-securities-nms-stock-and-other-securities.

[17] See Securities and Exchange Commission, "Amendments Regarding the Definition of 'Exchange' and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities," Federal Register 87, No. 53 (March 18, 2022): 15496-15696, available at: https://www.federalregister.gov/documents/2022/03/18/2022-01975/amendments-regarding-the-definition-of-exchange-and-alternative-trading-systems-atss-that-trade-us; and Securities and Exchange Commission, "Reopening of Comment Periods for 'Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews' and 'Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities,'" Federal Register 87, No. 92 (May 12, 2022): 29059-29061, available at: https://www.federalregister.gov/documents/2022/05/12/2022-10195/reopening-of-comment-periods-for-private-fund-advisers-documentation-of-registered-investment.

definition of "exchange."[18] The SEC also provided information about the application of the proposed amendments to trading systems for crypto asset securities and trading systems using distributed ledger or blockchain technology, including so-called "DeFi." In addition, the SEC solicited comment on alternative rule text to the proposed amendments to the SEC rule for the definition of exchange that was issued in January 2022.

The SEC continues to consider review and analyze comments received in response to this proposal.

E. Examining effects of leverage and fund liquidity risk management practices

As illustrated by the March 2020 stress event and discussed in the 2021 Staff Report, liquidity risk within certain types of investor positions and funds can amplify stresses in the Treasury market. The FSOC's interagency Hedge Fund Working Group (HFWG) further refined its monitoring of these vulnerabilities. Additionally, the Treasury Market Practices Group (TMPG), an industry-based group sponsored by the FRBNY, advanced multiple initiatives to enhance risk management as well as other market resilience objectives.

FSOC Hedge Fund Working Group

The HFWG has continued to refine its risk monitoring framework, which was developed in 2022 to monitor emerging threats, facilitate interagency communication during periods of market stress, and provide the FSOC with current information about hedge fund activities and possible financial stability threats. HFWG staff have briefed the FSOC on recent developments in risks related to hedge funds and current and potential policy initiatives regarding those risks.[19]

HFWG staff have identified three principal channels through which hedge funds can create financial stability risks: (1) by causing or contributing to market disruptions through large asset liquidations; (2) by transmitting risks to counterparties that are large, highly interconnected financial institutions; or (3) by reducing their financial intermediation, which could, under certain conditions, impair market functioning. The working group identified these channels based on several case studies, including the March 2020 Treasury market disruptions and the failure of Archegos Capital Management.

Hedge funds are among the significant participants in the U.S. Treasury cash-futures basis trade, which has reemerged as an active strategy over the past two years.[20] Asset managers have significantly increased their net long positions in Treasury futures, driving futures to trade at a premium relative to cash Treasury securities after accounting for carry and financing costs.

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[18] See Securities and Exchange Commission, "Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of 'Exchange,'" Federal Register 88, No. 87 (May 5, 2023): 29448- 29493. Available at: https://www.federalregister.gov/documents/2023/05/05/2023-08544/supplemental-information-and-reopening-of-comment-period-for-amendments-regarding-the-definition-of.

[19] See Financial Stability Oversight Council, "Minutes of the Financial Stability Oversight Council," December 14, 2023, available at: https://home.treasury.gov/system/files/261/FSOC_20231214_Minutes.pdf.

[20] For measures of the size of this trade, see Jonathan Glicoes, Benjamin Iorio, Phillip Monin, and Lubomir Petrasek, "Quantifying Treasury Cash-Futures Basis Trades," FEDS Notes, March 8, 2024, available at: https://www.federalreserve.gov/econres/notes/feds-notes/quantifying-treasury-cash-futures-basis-trades-20240308.html.

Participants in the basis trade arbitrage this spread by purchasing Treasury securities in the cash market, financing them in the repo market, and taking offsetting short positions in the Treasury futures market. In normal market conditions, basis trading may increase Treasury market efficiency by translating demand for Treasury futures contracts into demand for Treasury securities, reducing market segmentation, and improving overall market liquidity. Thus, basis trading can support the IAWG's principles of resilient and elastic intermediation and economic integration across markets. However, the growth of the basis trade can also increase the Treasury market's vulnerability to funding shocks or breakdowns in historical correlations.

Increases in hedge fund leverage and borrowing have accompanied the recent reemergence of the trade. The HFWG has been closely monitoring these developments. In July 2024, the OFR released a hedge fund monitor, which provides the public with additional insight into hedge fund borrowing and leverage trends.[21]

Additionally, the HFWG has continued analyzing the potential vulnerabilities associated with haircutting practices in the NCCBR market in light of the reemergence of the Treasury basis trade and the growth of hedge fund borrowing. As noted in the 2023 Staff Progress Report, low or zero haircut repo transactions are common and may represent a structural vulnerability during periods of market stress. IAWG member organizations have been considering how the SEC's recently approved central clearing rule, supervisors' work with banks to remediate deficiencies in counterparty credit risk management practices, and other steps may address these vulnerabilities.

Treasury Market Practices Group

The TMPG is an industry-based group sponsored by the FRBNY that seeks to support the integrity and efficiency of the Treasury, agency debt, and agency mortgage-backed securities markets. The TMPG investigates issues affecting covered markets and develops recommendations for best practices. Over the past year, the TMPG advanced several initiatives related to liquidity risk management as well as other IAWG workstreams.[22]

The TMPG continued its study of risk management practices in the NCCBR market.[23] After conducting outreach on risk management practices to a subset of firms that engage in the NCCBR market, the working group is drafting a white paper on NCCBR risk management practices, including a careful review of margining practices across different repo market segments.[24] Subsequently, the TMPG plans to consider whether any additions or revisions to its best practice guidance might be useful.

Additionally, the TMPG remains engaged on topics related to the SEC's central clearing rule, including access models at FICC and SIFMA's Treasury Clearing Standardized

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[21] The OFR's hedge fund monitor is available at: https://www.financialresearch.gov/hedge-fund-monitor/.
[22] For an overview of the TMPG's 2024 priorities, see Federal Reserve Bank of New York, "Treasury Market Practices Group 2024 Priorities and Potential Future Topics for Discussion," February 28, 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG_Priorities_022824.pdf.
[23] The TMPG established a working group to study NCCBR risk management practices in early 2023. See Federal Reserve Bank of New York, "TMPG Meeting Minutes," February 14, 2023, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/February-2023-TMPG-Meeting-Minutes.
[24] See Federal Reserve Bank of New York, "TMPG Meeting Minutes," May 14, 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/May-2024-TMPG-Meeting-Minutes.

Documentation Project.[25] The TMPG has also established a working group to review best practices related to risk management around service providers, critical venues, and clearing and settlement services in light of recent cyber events.[26] Finally, at the start of 2024, the TMPG updated its best practice recommendations to clarify practices around publishing voice trades to electronic trading screens to ensure consistent price transparency across voice and electronic trade execution.[27]

[25] See Federal Reserve Bank of New York, "TMPG Meeting Minutes," February 28, 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/February-2024-TMPG-Meeting-Minutes; Federal Reserve Bank of New York, "TMPG Meeting Minutes," April 11, 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/April-2024-TMPG-Meeting-Minutes.
[26] See Federal Reserve Bank of New York, "TMPG Meeting Minutes," June 25, 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/June-2024-TMPG-Meeting-Minutes.
[27] See Federal Reserve Bank of New York, "Treasury Market Practices Group Updates its Best Practice Recommendations to Promote Price Transparency," February 2024, available at: https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/PressRelease_022924.pdf.

Section 3: Conclusion

The staffs of IAWG member institutions continue to collaborate to ensure effective surveillance and enhance the resilience of the Treasury market. Their work over the past year has advanced these goals. The staffs intend for their work to continue to complement that of the FSOC and to align with the broad agenda laid out by the Financial Stability Board regarding core bond markets and nonbank financial intermediation. The staffs welcome continued engagement with academics, market participants, and other interested parties.