

## **2015 Roundtable on Treasury Markets and Debt Management**

### **Remarks by Counselor Antonio Weiss November 20, 2015**

*As prepared for delivery*

Good morning. Today's portion of the conference is dedicated to the evolving structure of Treasury markets, a theme we've focused on intensively over the past year. More specifically, it is a continuation of our work following the July release of the joint staff report on volatility in the Treasury market on October 15, 2014.

We are in the midst of the first comprehensive review of the Treasury market since 1998—years before algorithmic trading began in Treasuries. This is a priority for Treasury, and we will continue our close collaboration with the Federal Reserve Board, the Federal Reserve Bank of New York, the SEC and the CFTC. The supervisory and regulatory landscape of the Treasury market requires extensive coordination, and I'd like to recognize the high-quality work performed by the teams at all five agencies.

This morning, I will briefly review the key lessons of the Joint Staff Report, preview some themes we plan to cover in an upcoming Request for Information ("RFI"), and highlight our efforts to advance this process—in particular, our plans to obtain more data about Treasury market activity on a regular and timely basis.

#### ***Lessons of the Joint Staff Report***

The most important lessons of October 15<sup>th</sup> are not to be found in the details of what happened that morning, in what set that day apart. Rather, it is what that day had in common with every other day in the Treasury market that is most profound.

The October 15<sup>th</sup> Report shines a light on several developments that have fundamentally changed the Treasury market over the past 10 to 15 years. Our current review, building on the Report, is focused on bringing industry practices and regulatory standards fully up to speed with the new realities of our market. In the coming weeks, we will seek public comment on several of these developments, their implications for Treasury market functioning, and how both the private and public sectors might respond.

We are mindful in undertaking this review that the Treasury market is a complex ecosystem that serves us extraordinarily well. Indeed, the Treasury market remains the deepest and most liquid securities market in the world, and is the safe haven for investors in turbulent times. The Treasury market is the global benchmark for a well-functioning and trusted financial system, and our overarching aim must be to keep it that way for decades to come.

But it is equally important that we not take this status, nor the benefits it confers on U.S. taxpayers, for granted. As the Treasury market evolves, both the public and private sectors

must evolve with it. We need to further develop our thinking about risk management, about necessary monitoring and surveillance capabilities, and about the right level of transparency.

The most fundamental change that has occurred in Treasury markets is increased electronification across all types of market participants. Newer players deploying automated, high-speed trading strategies, are becoming increasingly prevalent, especially in the “on-the-run” securities.

“High-speed” is now, quite simply, the speed of markets across most benchmark securities. This is true in equities, futures, and foreign exchange; it is true domestically and internationally; and it is true across many traditional firms as well as new entrants.

### ***Key Themes and Questions***

This new reality brings new risks across several dimensions, as I have discussed previously. The first is operational risk, which is heightened in markets where decision-making is automated and message traffic is growing exponentially. The pressure on the plumbing, and the risk of an accident, can only increase as the race for speed intensifies. Market participants themselves are beginning to question whether the competition to shave one more millisecond helps or hurts market functioning. They have begun to respond with latency floors and other innovations that reduce the advantage of pure speed.

Risk is compounded by timing differences. Trading occurs in fractions of seconds, while margin is calculated and collected only once or twice a day, and settlement occurs over multiple days.

A second, and related, set of risks involves oversight and risk management. Players who account for major portions of trading activity in the Treasury market on any given day may not hold significant capital, and are not always subject to direct oversight of their infrastructure and risk management systems.

SEC Chair Mary Jo White recently highlighted steps the SEC has taken to improve operational integrity in equity markets, and asked whether those or similar steps might be adopted in the Treasury market. And just this week the Commission itself posed a series of questions about potential changes to the regulatory regime for Treasury market trading venues, as identified in the October 15<sup>th</sup> Report. CFTC Chairman Tim Massad also indicated that the CFTC will be proposing risk controls for automated trading systems, to reduce risks from malfunctioning or inadequately-tested trading algorithms.

A third category of risk involves market conduct. Recent allegations of spoofing in the futures market highlight the ways in which high-frequency trading strategies can potentially be used to manipulate market outcomes. And the October 15<sup>th</sup> Report highlighted the prevalence of self-trading, which accounted for 15 percent of transactions during the run-up in price in the first half of the “event window.” In both cases, the question of “intent” is important in distinguishing legitimate from potentially illegal

activity. When is an order a *bona fide* order, such that it represents genuine intent to transact? Are there identifiable benefits that accrue to the market from self-trading that off-set the appearance of impropriety? If so, how can authorities more clearly distinguish between “good” and “bad” self-trading? Are there structural changes to trading rules or practices that could help clarify these issues? These are questions we will continue to ask market participants and other stakeholders.

The fourth category is market resiliency. The October 15<sup>th</sup> Report asks whether the new market structure, which appears more liquid on average, may nonetheless be vulnerable to rare but severe bouts of illiquidity. If the nature of liquidity provision in the Treasury market is changing, how are market participants responding? How should policy makers think about these changes and the tradeoffs involved? How does liquidity provision differ in Treasury markets from futures to on-the-runs to off-the-runs?

We will discuss several of these questions on the forthcoming panel. But first I want to highlight a theme that underpins a proper assessment of any risk. That is, the need for more timely and comprehensive access to data. And we are moving forward with plans to collect the necessary data, and will engage in a dialogue on the appropriate level of public transparency.

### ***Prioritizing Data and Transparency***

There are two basic questions. The first is whether the official sector should have access to more comprehensive data in something closer to real time. Here, the answer is undoubtedly yes. There is broad consensus on the basic notion that the official sector needs better access to trading data, particularly in the Treasury cash market.

We are developing a comprehensive plan to achieve improved regulatory visibility into Treasury market trading. We will use available existing authorities to request and obtain much of the information we would require on a regular and ongoing basis, and will seek additional authorities if necessary. We will be deliberate, and engage extensively with all stakeholders as we proceed, but we are operating with a sense of urgency, on the premise that this simply must get done.

Beyond the initial hurdle of collecting the right data, analyzing these data routinely, especially across venues and markets, will likely require additional capabilities and infrastructure. As we build this infrastructure, we should contemplate not just our current challenges, but also the future needs of both regulators and a growing range of market participants. These are topics on which public input will be needed, and we will seek advice initially through the RFI.

As the October 15<sup>th</sup> Report demonstrated, analysis of the Treasury market necessarily involves sharing data among regulators. We must facilitate effective data sharing while safeguarding nonpublic information. To that end, our respective agencies are working toward a standing information sharing agreement—one of the specific next steps identified in the Report—and other tools as needed.

The second question with respect to data is perhaps more complicated: whether and how to provide greater transparency to market participants and the public at large about Treasury cash market trading activity.

On one level, this question appears straightforward: Why should Treasury securities, which are standardized and liquid, trade in a less transparent environment than corporate bonds or mortgage-backed securities, or even interest rate swaps.

Greater transparency can encourage participation by new entrants, who may otherwise be reluctant to engage in a market where they have less information than their counterparties. Greater transparency may also be desirable with respect to the practices governing trading and access at the various trading venues. Visibility into order types, access rules, and rulebooks may encourage greater competition and a more level playing field for market participants.

However, the Treasury cash market is not uniform. More recently-issued “on the run” securities trade largely on electronic platforms that operate much like public stock exchanges. Aged or “off the run” securities generally still rely on primary dealers to intermediate transactions. Full transparency may inhibit the willingness to engage in large so-called “block” trades by large investors and intermediaries. This may be particularly true in the less liquid parts of the Treasury market, where concerns about moving prices or revealing positions are stronger.

In the RFI, we plan to seek comment on whether market participants should have access to more detailed information about trading activity in the Treasury cash market and, if so, on what terms.

In a fragmented market with varying levels of participation across different venues, and varying levels of liquidity across different securities, we will need to balance the needs of many different types of market participants to achieve the desired outcome: the most robust, diverse, and liquid market possible. The RFI will provide an important opportunity to hear diverse opinions on the issues, and we will encourage participation by all stakeholders.

### ***Conclusion***

The analysis in the Joint Staff Report was critical in establishing a baseline of clear facts and hard data, not only about the events of October 15<sup>th</sup> but about the evolution of the Treasury market overall. We are now building on the Report by advancing the work identified in the next steps. We will seek input from stakeholders at every step, and encourage you and your organizations to participate in this dialogue. Where consensus emerges, or necessity demands, we will act.