August 26, 2022

The Honorable Secretary Janet Yellen
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Notice Seeking Public Comment on Additional Transparency for Secondary Market Transactions of Treasury Securities (Docket No. TREAS-DO-2022-0012)

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the above referenced request by the Treasury Department. We strongly support the Department's effort to increase transparency in the secondary market of Treasury Securities and outline our concerns and recommendations below.

Background

The U.S. Treasury market functions both as a securities market and a systemically important institution, in and of itself. Particularly following the passage of the Dodd-Frank Act in 2010, the financial system depends heavily on US Treasuries to maintain systemic stability, with financial institutions mandated to hold deep buffers of Treasuries as protection against sudden liquidity risks. The six trillion dollar repurchase (repo) market also relies heavily on US Treasuries as collateral in maintaining the safety of the marketplace. Prices of Treasury securities serve as a benchmark for virtually all other securities in the global financial market. The reasons for this reliance is straight-forward. Treasuries are perceived as *the* risk-free asset because: (i) the US is expected to always pay its debts on time, and (ii) the secondary market for trading US Treasuries will be liquid and maintain its liquidity. Therefore, it is of paramount importance that this market functions as efficiently and effectively as possible.

However, despite the systemic nature of this market, it is subject to an outdated regulatory regime far lighter than other key markets, like equity and derivatives.[1] Furthermore, the regulatory scheme that oversees the market is highly fragmented between a variety of agencies, with none having a lead agenda-setting authority.[2] The Treasury writes the rules, the Federal Reserve Bank of New York (FRBNY) facilitates debt auctions, the SEC and the Financial Industry Regulatory Authority (FINRA) supervise securities firms that trade Treasuries, the Fed monitors banks, and the Commodity Futures Trading Commission (CFTC) oversees the derivatives markets linked to Treasuries.[3]

[1] Yesha Yadav, The Failed Regulation of U.S. Treasury Markets, 121 Columbia Law Review. 1173 (2021). Pg. 1179
[2] *Id.* pg. 1177
[3] Jerry W. Markham, Regulating the U.S. Treasury Market, 100 Marq. L. Rev. 185, 199–230 (2016)

As the Interagency Working Group (IAWG) on the Treasury Market reported, although vast in size and importance, the market remains incredibly opaque and no single regulator or market participant has a comprehensive view of the market.[4]

The lack of transparency in the market has also created opportunities for abuse and manipulation. Large broker-dealers, such as J.P. Morgan, have recently been found guilty of deceptive Treasury trading practices.[5] The 2014 Flash Rally made clear that Treasury markets are, at minimum, vulnerable to disruptive trading practices.[6] In addition to highly abnormal trading and price instability, an investigation into the incident revealed an unusual amount of "self-trading" (or "wash trades"), representing around 14% of the market volume.[7] A recent study suggests that self-trading appears to be somewhat pervasive to Treasuries, representing 5% of overall volume in the interdealer market.[8] Additionally, in 2015, the Department of Justice also requested documents from all 22 primary dealers at the time, mostly banks, to investigate claims of rigging Treasury auction bids.[9]

The 2014 Flash Rally was one episode in a string of turmoil recently seen in the Treasury market. In September 2019, the repo market–which amongst other things, serves as a source of funding for Treasury trades– experienced a sharp and unforeseen spike in rates. Then there was the Covid-related market disruption of March 2020.[10] These disruptions triggered large-scale monetary interventions by the Federal Reserve, because the U.S. sovereign debt market is so critical to the global financial system.[11] In addition, periodically, the US Treasury secondary market suffers from sudden disruptions arising from unexpected disappearances in liquidity.[12]

The need for more data in the secondary market has become especially evident in light of these crises. Before TRACE reporting for Treasuries was introduced in 2017, regulators struggled to retrieve much needed data during the 2014 Flash Rally. This hampered their ability to piece together what went wrong, especially with data divided between the various agencies.[13]

The continual disruption in this market has called into question the "risk-free" status of the market by casting doubts on its resilience and predictability of its liquidity. This introduces novel systemic risk into the financial system and broader economy, as well as raises fundamental worries about the viability of this market as a producer of safe assets for the financial system.

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[4] *Supra* note 1. Pg. 1186.
[5] Securities and Exchange Commission. J.P. Morgan Securities Admits to Manipulative Trading in U.S. Treasuries. Sep 2020.
[6] U.S. Dep't of the Treasury et al., "Joint Staff Report: The U.S. Treasury Market on October 15, 2014." July 2015. App. C at pg 54.
[7] *Supra* note 1. Pg. 1221.
[8] James Collin Harkrader & Michael Puglia. Principal Trading Firm Activity in Treasury Cash Markets. Bd. of Governors of the Fed. Rsrv. Sys.: FEDS Notes. Aug. 2020.
[9] Keri Geiger and Alexandra Scaggs. "U.S. Probes Treasuries Niche That Investors Claim Is Rigged by Big Banks" Bloomberg. Nov 2015.
[10] Interagency Working Group. "RECENT DISRUPTIONS AND POTENTIAL REFORMS IN THE U.S. TREASURY MARKET: A STAFF PROGRESS REPORT" Nov 2021. Pgs. 7-17
[11] Darrell Duffie. "Still the World's Safe Haven? Redesigning U.S. Treasury Market After the COVID-19 Crisis." Brookings, Hutchins Ctr. Working Paper No. 62. June 2020.
[12] *Supra* note 6.
[13] *Id.* pgs 47-48.

Importantly, the "risk-free" perception of U.S. debt has significant advantages to taxpayers. It allows the government to borrow at record low rates. Increasingly, the government has relied upon debt to fund its domestic programs. Many of the emergency and stimulus programs implemented during the COVID-19 pandemic were funded by quickly and expansively accessing the government debt market and selling Treasuries to the global investing public.[14]

Tellingly, auctions are starting to experience disruptions and performing subpar as well. The June 2022 auction, for example, saw abnormal yields on Treasury bills, and auctions in 2021 also saw decreased demand.[15] While a shakier Treasury secondary market is certainly not the only reason for tapered demand, if investors think they will have liquidity issues in the secondary market, they may well be rationally disincentivized from buying Treasuries at auction.

For these reasons, we support the Treasury's goal to increase transparency in the secondary market of Treasuries.

Post-trade Transparency Considerations

Since July 2017, SEC-registered broker-dealers that are FINRA members have reported their Treasury transactions to TRACE.[16] The data includes all transactions where a FINRA member is a counterparty, including FINRA members that are alternative trading systems (ATS). Weekly aggregated volume data started becoming public in March 2020 and historical data back to January 2019 was released in May 2021.[17]

Additionally, FINRA is considering the following changes: (1) require more granular timestamps where applicable, (2) shorten the reporting time frame from end-of-day to within 60 minutes in most cases, (3) standardize price reporting, including separating ATS fees, and (4) introduce new modifiers to identify non-ATS venues, methods of execution, trading units within a firm executing a trade, multi-leg trading strategies, and methods used to clear and settle transactions.

However, the market is still rife with asymmetrical data for many market participants. For example, FINRA's reporting mandate doesn't apply to hedge funds and high frequency traders (or principal trading firms), which often do not qualify as FINRA-regulated firms. There have also been ongoing issues surrounding the consolidated collection of bank trading data and including it within FINRA's reporting regime. This creates asymmetry in who is subject to the regime as well as how data is collected and consolidated, and by which agency. To be sure, the Federal Reserve Board of Governors has proposed mandating banks to report trades to TRACE, but the collection of daily transactions in marketable Treasuries from banks is not scheduled to begin until September 2022.[18]

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[14] Scott Horsley. "U.S. Treasury To Borrow $3 Trillion In 3 Months To Pay For Pandemic." NPR. May 2020.
[15] Colby Smith. "Investors fear new Treasury auctions will set off repeat bout of selling." Financial Times. March 2021.
[16] FINRA Regulatory Notice 16-39. " Reporting Transactions in U.S. Treasury Securities." October 2016.
[17] *Supra* note 9. Pg. 27.
[18] Fed. Res. System. Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB. 86 FR 59716. October 2021.

Additionally, some market venues may disseminate information to their subscribers in a timely manner, but there is no centralized collection of that information from all relevant sources. For example, while last trade price and quantities are generally disseminated to ATS subscribers in real time, the information would not be provided until significantly later for TRACE-dependent traders. FINRA's TRACE currently collects this information in other fixed income securities to improve post-trade transparency, and has demonstrated that it can disseminate such information in a timely manner upon report receipt.

As the interdealer Treasuries trading market, especially for on-the-run Treasuries, has evolved to mirror the equities market, including the increasing prevalence of high frequency traders (HFTs), several minute delays in reporting when the market transacts by the microseconds provides ample time for the market to lose critical information for most efficient pricing as well as for overall surveillance.[19] Delays in information in a market can result in damaging levels of opacity, allowing mispricing and misconduct to take hold in the absence of dedicated and well-tailored surveillance. As noted above, the US Treasury market has experienced a slew of problematic incidents that raise concerns about the overall quality and integrity of the market. Further, as noted above, the light regulatory regime can encourage such behaviors owing to fewer checks on conduct.

Pros and Cons of Real Time Reporting and Recommendations

While we always advocate for high levels of transparency in a given market, we understand the uniqueness of the Treasury market. It is both a securities market and a systemically important institution affecting the global financial system, fiscal policy, and national security. For the latter reasons, disruptions to this market can have more far-reaching consequences than disruptions in other securities markets.

For these reasons, while we support and strongly recommend real-time reporting and dissemination of transaction-level details on trades in the inter-dealer market, we understand the concerns raised surrounding the real-time reporting of large block trades, particular in the dealer-client market. For one, clients can range from other nation states, to pension funds, to corporations. If a hostile country, for example, was offloading Treasuries and that information was disseminated in real time, it is very easy to imagine the chaos that would ensue throughout the Treasury and global financial markets. Furthermore, the dealer-to-client market typically trades more off-the-run Treasuries that tend to be more illiquid than the on-the-run market.[20] Large block trades can have a significant impact on price. But these scenarios can easily be dealt with by implementing a time-delay for disseminating information on block trades, as is done in the swap market or allowing for slight delay in reporting as is done with corporates and agency bonds.

However, we believe that trades in the interdealer market need to be reported and disseminated in real-time, and for data collection to be undertaken on a granular level. This

[19] *Supra* note 9. Pgs. 21, 36–39

[20] Group of Thirty Working Group on Treasury Market Liquidity. (2021). U.S. Treasury Markets: Steps Toward Increased Resilience. Pg. 1

market, as noted above, has come to represent one comparable in many ways to equity markets. Trading is undertaken at rapid speeds on an automated basis between the primary dealers and other firms, such as principal trading firms. Trading volume is increasingly dominated to a large degree by the principal trading firms. The market thrives on efficiency. It also offers price discovery alongside the futures market for Treasuries. Hence, there is very little reason for these trades, especially for the on-the-run Treasuries, not to be reported on as soon as possible on a very granular level and disseminated in real-time.

Overall, increasing the post-trade transparency in the secondary market for all segments of the Treasury market will increase liquidity, reduce transaction costs, and enhance price efficiency.

Additional Recommendations

We would also like to take the opportunity to urge the Treasury department to improve transparency in the pre-trading data. While improving post-trade transparency will improve price discovery, transparency in the market will also be improved by instituting central clearing and expanding TRACE reporting to include all transactions in the Treasury cash market, including transactions made by commercial banks. It is difficult for investors and other market participants to accurately assess the quality of their trade executions without both pre- and post-trade price transparency.

AFREF looks forward to continued engagement with the Treasury Department on this matter. Given the benefits, we believe the Department should work swiftly to bring much needed transparency to the U.S. Treasury market. For further discussion, please contact Renita Marcellin renita@ourfinancialsecurity.org or Andrew Park at andrew@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform Education Fund