MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

November 28, 2018

Via Electronic Mail: tmpg@ny.frb.org

Treasury Market Practices Group
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Re: Treasury Market Practices Group ("TMPG") White Paper on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities ("White Paper")

Dear TMPG Members:

Thank you for meeting with Members and Staff of the Managed Funds Association[1] ("**MFA**"). We appreciate your outreach in order to learn more about the TMPG and its initiatives in the U.S. Treasury market. We commend the TMPG for publishing the White Paper, which provides a detailed description of current clearing and settlement practices in the U.S. Treasury market.

As you know, our Members transact in all sectors of the U.S. Treasury market (including cash, repurchase agreements ("**repo**"), and futures) as part of overall investment and hedging strategies. These markets are critical to the global economy and our Members want to ensure that they remain efficient, fair, liquid, and transparent for investors. We have previously provided recommendations to regulators regarding potential enhancements to the regulatory framework for U.S. Treasuries,[2] some of which directly relate to the findings in the White Paper. We provide our feedback to the White Paper below.

I. Central Clearing in the Dealer-to-Customer Market

The White Paper highlights that, despite an increase in electronic trading, clearing and settlement practices have not materially evolved in the dealer-to-customer segment of the market. As a result, most all dealer-to-customer secondary-market transactions are settled bilaterally outside of a central clearinghouse.

[1] Managed Funds Association ("**MFA**") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA to David R. Pearl, U.S. Department of the Treasury, dated April 22, 2016, (includes MFA's letter to the SEC on Regulation of NMS Stock ATSs, recommending that requirements should be extended to alternative trading systems that trade Treasuries) available at: https://www.managedfunds.org/wp-content/uploads/2016/04/MFA-Treasury-RFI-Final.Appendix-4.22.16-1.pdf.

While the White Paper notes a number of potential risks associated with current bilateral clearing and settlement practices, it does not explore in detail why bilateral settlement predominates in the dealer-to-customer segment of the market. We recommend that the TMPG document the elements of current market structure that lead to bilateral dealer-to-customer settlement, including (a) Fixed Income Clearing Corporation direct membership criteria, (b) the lack of a client clearing solution for cash U.S. Treasuries, and (c) the lack of a client clearing solution for bilateral U.S. Treasury repos.

As noted in the White Paper, central clearing can be expected to lead to significant benefits, such as greater transparency, liquidity, and resiliency, and fewer credit and operational risks. In addition, increased central clearing of repos would lower transactions costs by allowing market participants to net more of their transactions, and lead to greater liquidity in the U.S. Treasury markets.

For a variety of reasons, central clearing for dealer-to-customer trading in the U.S. Treasury markets has not developed. While clearing and operational risks related to bilateral clearing can be effectively managed, we believe it is important for regulators and the industry to work together to develop an effective dealer-to-customer clearing model for both cash and repo transactions. We urge the TMPG to take a leadership role in identifying barriers that are preventing dealer-to-customer clearing of U.S. Treasuries.

II. Trading Venue Best Practices and Regulatory Oversight

The White Paper highlights the central role that multilateral trading venues play in the U.S. Treasury market, noting that three interdealer broker ("**IDB**") platforms currently account for a substantial share of all electronic IDB activity. Multilateral trading venues that operate in the dealer-to-customer segment of the market received less attention in the White Paper but create similar risks from a resiliency perspective given their limited number and overall importance to market participants. To build on the TMPG's work, we think it would be a valuable practice for both IDB and dealer-to-customer multilateral trading venues to proactively disclose to their members relevant facets of their clearing and settlement practices so members can evaluate those risks and take precautionary measures, as necessary or appropriate.

In addition, we recommend that the TMPG specifically consider the resiliency risks associated with both IDB and dealer-to-customer multilateral trading venues. In this regard, it will be important to consider whether identifying best practices can improve overall market functioning and resiliency, or whether multilateral trading venues should also be subject to consistent regulatory oversight, such as by requiring registration with the SEC as an alternative trading system ("**ATS**"). In our experience, U.S. Treasury trading venues provide less transparency to market participants than those that operate in other asset classes. For example, ATSs that trade national market system stocks are now required to disclose information regarding their rules, membership criteria, trading protocols, fees, and potential conflicts of interest. ATSs with considerable stock volume are also subject to Regulation SCI, which sets standards with respect to various operational topics including risk controls, systems testing and cybersecurity.[3] In our view, market participants operating in the U.S. Treasury market would benefit from similar disclosures and operational standards, and we recommend that the TMPG consider whether best practices should be established in this area that are consistent with established market practices in other asset classes.

[3] 17 C.F.R. §§ 242.1000 – 242.1007.

III. Diversity of Market Participants

The White Paper notes that market participant diversification has increased in the interdealer segment of the market. In our view, as supported by studies of other markets,[4] a more diverse pool of market participants enhances liquidity and market resiliency, especially in times of market stress. As such, we recommend that the TMPG consider whether additional best practices are appropriate to support this trend of increasing diversification, along with addressing any potential risks resulting from this evolution in market structure. For example, multilateral trading venues in the U.S. Treasury market should be expected to provide non-discriminatory access to market participants in order to ensure that all investors have access to relevant liquidity pools.

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Thanks again for the opportunity to provide comments on the White Paper and your interest in hearing from MFA more broadly on the Treasury market. Please feel free to contact me at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han
Jennifer W. Han
Associate General Counsel

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[4] *See, e.g.*, FX Markets Move on Surprise News, JPMorgan Chase & Co. Institute, June 2018 (finding that hedge funds and market makers played an especially significant role in the establishment of a post-event market equilibrium after Brexit, the US election, and the Swiss Franc floor) available at: https://www.jpmorganchase.com/content/dam/jpmorganchase/en/legacy/corporate/institute/document/institute-fx-markets-move-on-surprise-news.pdf; Joint Staff Report: The U.S. Treasury Market on October 15, 2014, July 13, 2015, available at: https://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf; *and* Findings Regarding the Market Events of May 6, 2010), Report of the Staffs of the CFTC and SEC, September 30, 2010, available at: https://www.sec.gov/news/studies/2010/marketevents-report.pdf.