INVESTMENT COMPANY INSTITUTE

**MEMO# 31737**

April 29, 2019

# Member Call on May 9 to Discuss TMPG Proposed Best Practices

[31737]

April 29, 2019 TO: Chief Risk Officer Committee
Equity Markets Advisory Committee
Fixed-Income Advisory Committee
Operations Committee
Securities Operations Advisory Committee RE: Member Call on May 9 to Discuss TMPG Proposed Best Practices

In July, the Treasury Market Practices Group (TMPG)[1] issued a consultative white paper on clearing and settlement in the secondary market for US Treasury securities ("White Paper").[2] The White Paper described the clearing and settlement arrangements for US Treasury securities, provided detailed maps that illustrate the process flows, and catalogued potential areas of risk. Based on feedback TMPG received on the White Paper, it now has issued proposed updates to its best practices for Treasury, agency debt, and agency mortgage-backed securities markets.[3] The proposed updates address several risk and resiliency issued identified by the TMPG in the White Paper and are intended to promote efficient clearing and settlement in these markets. The TMPG also identified certain clearing and settlement issues that are outside the remit of the group's best practices, where the TMPG believes further review by public- and private-sector stakeholders is warranted. **The TMPG has requested public comment on the proposed best practices and the areas identified for further review by June 17, 2019.**[4]

**ICI has scheduled a member call to discuss the TMPG's proposed best practice recommendations and areas identified for further review, both of which are summarized below. The call will take place on Thursday, May 9th, from 2-3 pm ET. The dial-in information for the call is:**

**Dial-in number: 888-701-8647 Passcode: 63638**
**If you plan to participate in the call, please RSVP to Jennifer Odom at jodom@ici.org.**

### Summary of Proposed Best Practices

The TMPG recommends that market participants in the Treasury, agency debt, and agency MBS markets apply rigorous risk management to clearing and settlement practices for all products, including instruments with high credit quality or a short settlement cycle. The proposed best practice recommendations fall into two broad areas.

First, the TMPG recommends market participants increase their attention to counterparty risks in the clearing and settlement process, including:

- understand the role of various entities in the clearing process;
- understand whether a counterparty is acting as principal or agent in a trade at different points in the trade life-cycle;
- use the appropriate set of tools to manage counterparty risk while considering factors like speed and volume of trading;
- understand the depth, breath, and durability of any credit enhancements provided; and
- be attentive to potential liquidity needs, particularly in contingent events.

Second, the TMPG recommends market participants strengthen clearing and settlement related operational resiliency, planning, and processes, including:

- periodically evaluate all clearing options available;
- plan for potential lack of access to service providers and critical trading venues as well as clearing and settlement services;
- recognize that operational disruptions may have systemic implications; and
- ensure that trade matching and block allocations occur as close to real-time as possible and, at a minimum, by the end of trade date.

## Summary of Clearing and Settlement Issues Identified for Further Review

The TMPG also identifies several clearing and settlement issues which the TMPG believes warrant further review by public- and private-sector stakeholders. While the TMPG did not reach its own conclusions on these issues, the group recommends that public- and private-sector stakeholders conduct a review of whether the regulation and oversight of market participants and trading venues remains fit for purpose, the potential role of expanded central clearing in mitigating risks, and the adequacy of risk management safeguards.

These issues include:

- **Review of regulation and oversight of market participants.** Participants in the Treasury market are not all regulated in the same manner (or regulated at all), depending on their business model and whether they act as an intermediary (e.g., broker, bank), an end user (e.g., asset manager, corporate), a market maker (e.g., dealer, a Principal Trading Firm (PTF)), or another type of participant. The TMPG states that changes to market structure have resulted in certain types of market participants representing a substantial portion of activity, particularly on inter-dealer broker (IDB) platforms, but also in the market more generally. These include PTFs, as well as hedge funds and other asset managers that may take very large directional positions in the Treasury market. The TMPG believes it is worth considering whether existing regulation and oversight needs to evolve to reflect changes in market participation, particularly whether regulation and oversight of various types of firms and activities are commensurate with their significance and potential risks to the marketplace.
- **Assess regulation and oversight of government securities trading platforms.** The TMPG notes that trading platforms for Treasury cash products are not regulated to the same extent as those for comparable platforms offering trading in equity or other

non-government securities, primarily as a result of the SEC's Regulation Alternative Trading System (Reg ATS), which does not apply to ATSs that solely trade government securities. The TMPG asks whether public policy interests would be advanced by eliminating this exemption. The TMPG believes that the same types of considerations and concerns that have driven regulation in the equity trading platform space are of at least equal importance to government securities trading as well.

- **Potential role for expanded central clearing in mitigating clearing and settlement risk.** The TMPG observes that there has been a substantial increase, in both absolute and percentage terms, of the number of trades in the Treasury market that clear bilaterally rather than via a central counterparty. This is principally due to the increased prevalence of PTF activity on IDB platforms, which activity does not centrally clear. The TMPG explains that, although members of the TMPG did not form a consensus view as to whether increased use of central clearing services should effectively be compelled, there was agreement that certain market participants were less likely to voluntarily move to more widespread use of central clearing in the current environment. The TMPG believes that the official sector is in the best position to address whether increased use of mandatory clearing should be incentivized or required.
- **Adequacy of risk management safeguards of clearing firms, trading platforms, and CCPs.** The White Paper noted the critical role played by entities such as clearing firms, trading platforms and CCPs in the secondary market for Treasury securities. Some commentators questioned whether current or prospective trading platforms and clearing firms have adequately assessed the sufficiency of their clearing and settlement risk management mechanisms, including liquidity and financial resources to effectively withstand a market stress event. The TMPG believes that it is prudent for public- and private-sector entities (e.g., regulators, clearing firms, trading platforms and all market participants that act as principals in a trade) to understand the robustness of underlying risk management mechanisms, including the netting arrangements and the sufficiency of the liquidity and financial viability resources available. The TMPG also notes that a common theme in the feedback to the White Paper was to encourage CCPs to consider changes in their business operations and risk management practices to address any risks they may face in contingent scenarios.

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**endnotes**

[1] The TMPG is a group of market professionals sponsored by the Federal Reserve Bank of New York that describes itself as "committed to supporting the integrity and efficiency of the Treasury, agency debt, and agency mortgage-backed securities markets. The TMPG is composed of senior business managers and legal and compliance professionals from a variety of institutions — including securities dealers, banks, buy-side firms, market utilities, and others . . ." *See* https://www.newyorkfed.org/TMPG/index.html.

[2] TMPG Consultative Paper, *White Paper on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities*, *available at* https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS-DraftPaper-071218.pdf. The TMPG also provided a set of detailed maps related to the White Paper that illustrates the process flows, and catalogs potential areas of risk (*available at* https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS-Maps-071218.pdf).

[3] *See* TMPG Consultative Note, *Treasury Market Practices Group Proposed Practice Guidance on Clearing and Settlement*, *available at* https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG_CS_BPs_Note_4.2019.pdf.

[4] *See* TMPG Press Release (Apr. 18, 2019, *available at* https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG_CS_BPs_Press_Release_Apr_2019.pdf.