ISDA Safe, Efficient Markets

ISDA/SIFMA Treasury Forum:
Changing Treasury Markets
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Opening Remarks
Scott O'Malia, ISDA Chief Executive

Good morning, and welcome to the Treasury Forum. First, let me thank CME Group, our founding sponsor, for supporting this event once again – we really appreciate it. I'd also like to thank SIFMA for its partnership on today's forum.

The theme for this event is 'changing Treasury markets' – and change they most certainly will. Next year will see the first parts of the Securities and Exchange Commission's (SEC) Treasury market reforms come into effect, including a requirement to clear certain cash Treasuries for the first time.

This represents a massive structural shift for a market that plays such a vital role in keeping the wheels of the global financial system turning. As a result, we need to think very carefully about what those changes will entail and ensure there's plenty of time to prepare. But we also can't consider these requirements in isolation – we should think hard about the impact of various rules in combination to ensure policymakers achieve the outcome they want: a resilient, efficient Treasury market.

In my remarks this morning, I'll briefly summarize the issues we as an industry need to consider before implementation, and why an early start is imperative. I'll then explain why we think changes are needed to certain prudential requirements to ensure policymakers are moving in the same direction.

Preparing for change

Let me start with the rules themselves.

The SEC finalized its regulations last December, with implementation split into two stages. Separation of customer and house margin, a broker-dealer customer protection rule and a requirement to ensure access to clearing will come into effect from March 31, 2025. The clearing mandate for certain specified Treasury transactions will begin a little later, starting with cash trades from December 31 next year, followed by repo six months later.

This seems like a lot of time. It's really not. As demonstrated by the efforts to introduce clearing in the derivatives markets a decade ago, and – more recently – the implementation of margin requirements for non-cleared derivatives, a change of this scale will take time and careful thought.

Among other things, market participants will need to assess future and existing clearing models to determine which best suits their needs. Legal documentation will need to be developed, negotiated and executed, and regulatory-compliant structures for the segregation of client margin will need to be put in place and tested – a massive undertaking that will take time given the number and diversity of Treasury market participants.

To put this in context, similar steps taken to comply with margin requirements for non-cleared derivatives took several years, and the rules were rolled out in phases between September 2016 and September 2022.

Doing all of this for the deepest and most liquid securities market in the world in the time available will be challenging. We therefore urge market participants to start thinking about these issues now.

For our part, ISDA will continue to engage closely with members and regulators and assist with implementation where we can – for instance, by providing input on client clearing models and appropriate documentation, as well as by continuing to hold educational events like today.

This represents a major transition, and it will require time and a collective effort from the entire industry to implement.

Moving in the same direction

Let me now turn to other areas where we think changes are necessary.

The SEC's Treasury reforms are part of a program of work to improve market resilience following a series of stress events. This includes the dash for cash in March 2020, which exposed the susceptibility of the US Treasury market to liquidity shocks during periods of volatility. Proponents say broader clearing of US Treasury securities will help reduce settlement risk, enhance liquidity and increase balance sheet capacity.

However, we think certain aspects of the US prudential rules are inconsistent with those objectives. For example, the US Basel III proposal and changes to the surcharge for global systemically important banks (G-SIBs) would constrain balance sheets and could force banks to scale back or withdraw from certain intermediation activities. Nowhere is this more evident than central clearing. According to an impact study by ISDA and SIFMA, the proposals would increase capital for clearing businesses by more than 80%.

Moreover, the supplementary leverage ratio (SLR) serves as a non-risk-sensitive binding constraint on banks and can impede their ability to act as intermediaries, including their capacity to clear for clients. That's particularly the case in times of stress. At the height of the global pandemic in April 2020, this was a serious enough concern to prompt the Federal Reserve to temporarily exclude US Treasury securities from the SLR calculation.

We think regulators should closely consider the impact of various rules in combination to achieve consistent policy goals. In this context, a permanent exclusion of US Treasury securities from total leverage exposure would free capacity for banks to participate in US Treasury markets and facilitate access to cleared markets, especially during periods of stress.

This would better promote the stability and resilience of the US Treasury market and give banks more certainty to expand balance sheet capacity than a temporary regime introduced during a market stress that will later be reversed.

ISDA and SIFMA have also proposed several calibration changes to the US Basel III and G-SIB proposals to better reflect actual levels of risk. These include changes to certain aspects of the rules for credit valuation adjustment and modifications to the complexity and interconnectedness categories of the G-SIB surcharge.

We strongly believe the capital rules should be consistent, risk-sensitive and appropriate. Disproportionate increases in capital could force banks to retreat from certain trading and intermediary businesses, creating capacity constraints and raising financing and hedging costs for end users.

I said earlier that the theme of this event is changing Treasury markets. All of us – market participants and regulators – need to work together to ensure this change is managed appropriately and on time, and we avoid potential impacts on liquidity and market capacity.

Thank you.