

Clearing and Settling in the Treasury Market

November 28, 2017

Background

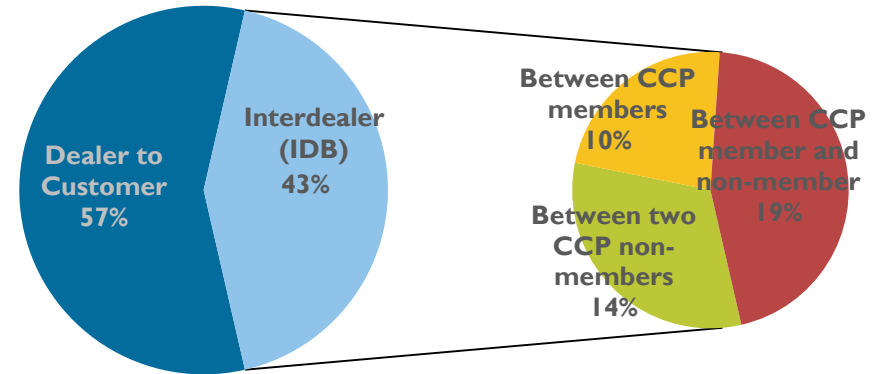
- ▶ **What is clearing and settlement?**
 - Clearing is process of transmitting, reconciling and confirming transactions prior to settlement; and can also include bilateral or multilateral netting of transactions.
 - Settlement is the exchange of securities for trade proceeds that completes the trade cycle.
- ▶ **Why is it important to learn about clearing and settlement?**
 - Due to recognition that contingent events can disrupt these typically benign post-trade processes, with potential to create systemic risk for the Treasury market that can easily transit to other financial markets.

Motivation for TMPG work

- ▶ Why did the TMPG initiate this work?
 - The Joint Staff Report (2015) on the Treasury flash rally and Treasury's Request for Information (2016) highlighted the advanced use of technology and the growth of new Treasury market participants.
 - TMPG wanted to gain a better understanding of how clearing and settlement processes have evolved given this structural change.

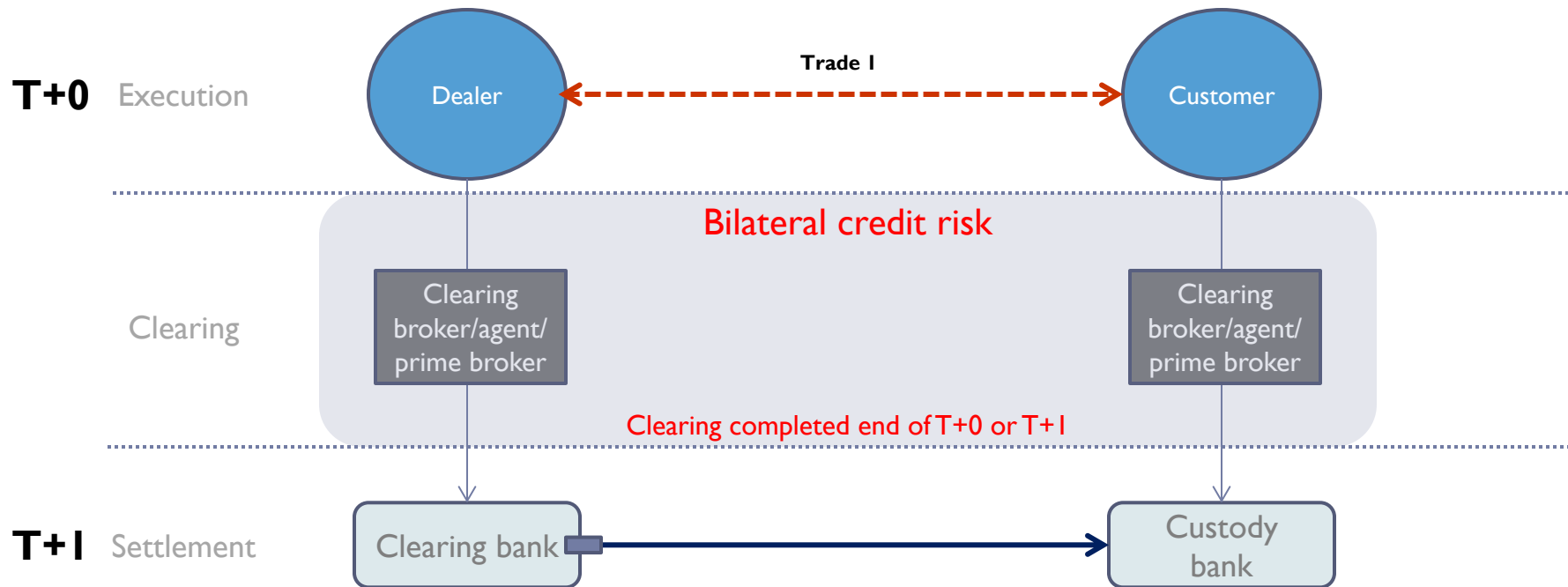
Treasury cash market spheres

- ▶ Two segments in Treasury market
 - Dealer to customer segment (clears bilaterally)
 - Inter-dealer segment (various arrangements based on the counterparties)

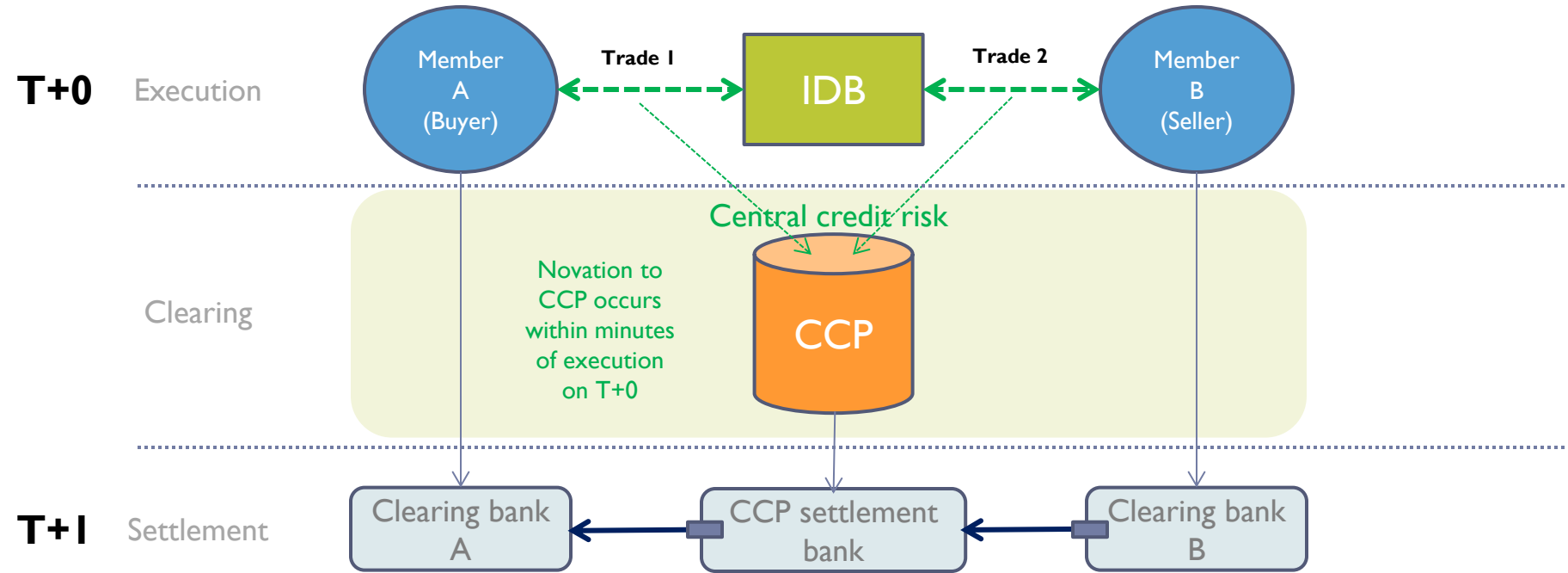


Notes: The figures are estimated using FR 2004 data covering the first half of 2017 and various assumptions, including that a) primary dealers account for all dealer activity, b) 5% of dealers' trading not through an IDB is with another dealer, c) the shares of dealer and non-dealer activity in the IDB market for coupon securities equal the weighted averages of the shares reported in the October 15 report (that is, 41.5% and 58.5%, respectively), d) only dealers trade bills, FRNs, and TIPS in the IDB market, and e) the likelihood of dealer and non-dealers trading with one another in the IDB market solely reflects their shares of overall volume.

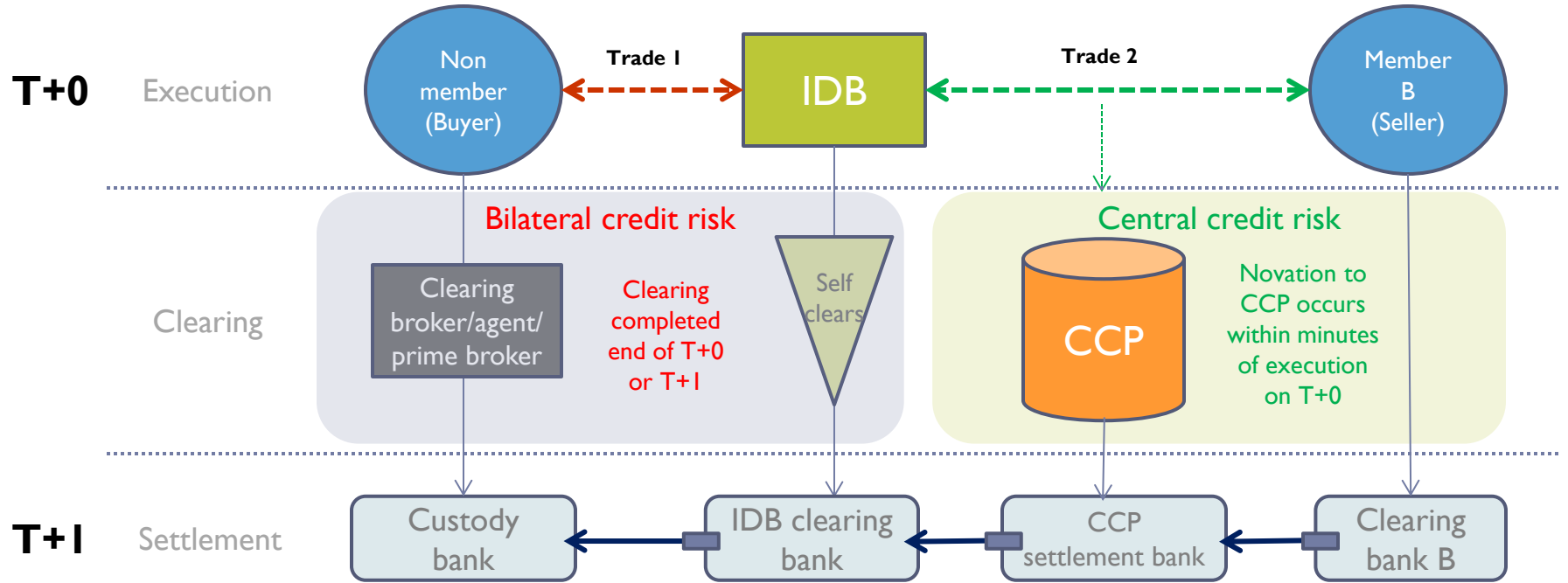
Trade between dealer and customer



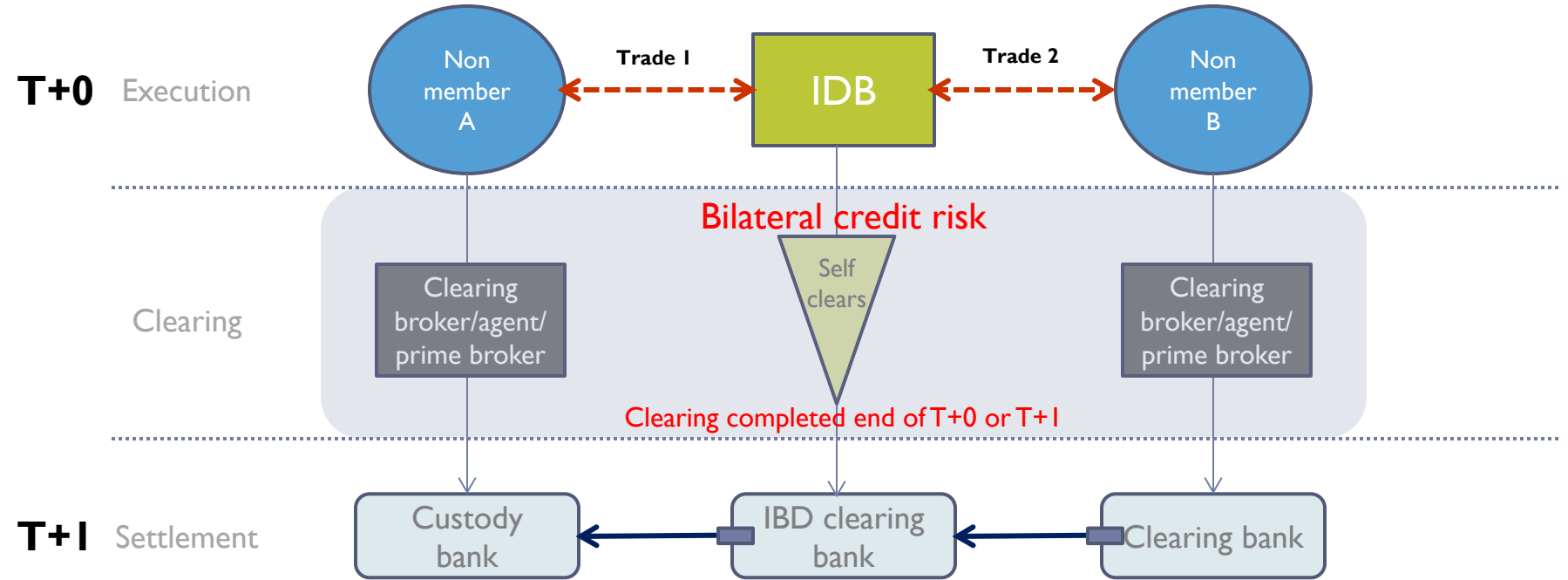
Trade between two CCP members



Trade between a CCP member and non-member



Trade between two CCP non-members



Risks in clearing & settlement

- ▶ Counterparty default risk
- ▶ Credit risk mitigation for central and bilateral clearing differs
- ▶ Information asymmetries
 - Credit enhancement arrangements
 - CCP visibility into members' gross trading activity
- ▶ Room to improve timeliness of trade matching
- ▶ Contingency risks
 - Impairment of electrical grid
 - Cyber events
 - Algo malfunctions (a.k.a. coding errors)

Questions