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April 22, 2016

David R. Pearl  
Office of the Executive Secretary  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Re: Request for Information on Evolving Treasury Market Structure

Dear Mr. Pearl:

TD Securities (USA) LLC welcomes the opportunity to respond to the U.S. Department of Treasury's Request for Information on the Evolution of the Treasury Market Structure (RFI). The RFI raises important structural issues which affect market functioning and resilience.

We will address the RFI in four sections, following the numbering in the RFI.

**Section I: Further Study of the Evolution of the U.S. Treasury Market and the Implications for Market Structure and Liquidity**

Despite the accommodative nature of monetary policy, we have observed a sporadic deterioration in Treasury market liquidity over the last two years. Liquidity in the Treasury market is essentially bifurcated, with variations depending upon the asset class (on-the-runs versus off-the-runs versus futures or TIPS versus nominals), size of the transaction and time of the transaction. We believe that market depth is significantly shallower for a larger transaction or when volatility rises. These pockets of illiquidity, however, are challenging to capture in an average metric. This different liquidity environment has manifested itself in outsized moves (albeit within a narrow range) in the 10 year Treasury bond.

This changed environment may be a result of lower dealer risk appetite in rates due to the Supplementary Leverage Ratio (SLR), which has dramatically increased the cost of funding. The rapid growth of algorithmic trading and proliferation of non-dealer Principal Trading Firms (PTFs) has also changed the market microstructure. Algorithmic trading now accounts for more than half the activity on inter dealer trading platforms for cash Treasuries. PTFs provide significant liquidity in a low volatility environment, particularly for on-the-runs and smaller trade sizes; when volatility rises, however, their activity diminishes. The key issue is that with the advent of the SLR, the business model for dealers makes it difficult for them to step in during these periods of heightened volatility.

The current environment explains the widening of the spread between on-the-runs and off-the-runs, futures and cash, and swaps and Treasuries. Theoretically there should be an arbitrage opportunity in selling futures and buying the cheapest to deliver bond. At expiration of the contract every 3 months, the investor who is long the cash can deliver the bond into the contract. The fact that the spread is persistent is testament to the constraints on dealer balance sheet.

**Section II: Continued Monitoring of Trading and Risk Management Practices Across the U.S. Treasury Market and a Review of the Current Regulatory Requirements Applicable to the Government Securities Market and Its Participants**

Dealers and PTFs face very different regulatory regimes with respect to registration requirements, capital needs, liquidity ratios, examinations, supervision and rules of conduct. This can create an uneven playing field for Treasury market participants, and regulators might consider harmonizing some of these rules.

We also believe that there are risks to the clearing and settlement infrastructure posed by the PTFs. A majority of benchmark cash volume is now executed by non-Central Counterparty member firms and cleared at the inter dealer brokers (IDB) which intermediate intraday settlement risk. An intraday failure by a PTF could threaten the IDB settlement model and pose systemic risk. Mandating central clearing could be a useful step in managing this intraday risk.

While circuit breakers do work in other markets, it may not be feasible in Treasuries due to the number of products and platforms in which they are traded. Self-trading, for example, can provide an illusion of liquidity. Interestingly, the Joint Staff Report on the October 15, 2014 episode highlighted that self-trading by PTFs in 10 year futures increased to 6.4% on October 15, 2014 vs 4.4% during a control period. For dealers, self-trading as a percentage of total volume increased to 0.6% from 0.4%. Since different desks within the same firm may operate independently, Treasury should consider the logistical difficulties in explicitly prohibiting self-trading.

**Section III: An Assessment of the Data Available to the Official Sector on U.S. Treasury Cash Securities Markets**

We fully support the official sector accessing trade level data related to the Treasury market. The only downside of providing more information is the reporting burden that it places on smaller dealers. With this in mind, we would recommend that Treasury target its data gathering requirements first on the IDBs, futures exchanges and electronic dealer-to-customer platforms. These entities comprise the infrastructure through which the majority of trading occurs across market segments and would allow for the most cost effective way to record all of the relevant pre- and post-trade metrics.

For voice and other direct dealer-to-customer transactions (including through proprietary dealer systems), if a primary dealer is involved, then it should be their responsibility to include the transaction in a daily transaction report. These transaction

reports should include, per trade, the issue, volume and price action, time and date of execution and an indication of the category of market participant on either side of the transaction.

**Section IV: An Assessment of the Data Available to the Public on U.S. Treasury Cash Securities Markets**

Treasury should have access to the information it needs to ensure a fair and resilient market, and we support transparency. Treasury should consider, however, whether there may be unintended consequences of releasing transaction information, including whether and the extent to which doing so may negatively impact market liquidity. Examples of groups that could suffer from these unintended consequences include large investors and market makers.

We believe that in a similar vein, setting an industry reporting requirement similar to TRACE could have negative ramifications for the Treasury market. Unlike the corporate market, the size of a standard Treasury transaction is much larger, and investor holdings of Treasuries often dwarf their corporate holdings. Thus, replicating the corporate bond model of TRACE for the Treasury market may not be appropriate from a market functioning point of view.

We appreciate Treasury's consideration of our comments and suggestions, and we would be happy to help clarify or elaborate on any point. If you have any questions, please do not hesitate to contact me with any questions or for further information.

Yours sincerely,



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