Friday, November 12, 2021

Taking Their Time On the Treasury Market

Summary

As Mark Calabria made clear earlier this year, reform of the Treasury market has direct, major impact on that for agency debt and MBS. Indeed, given ongoing Treasury-obligation issuance uncertainties at a time of brute-force fiscal policy along with continuing debt-ceiling drama, the two high-quality liquid assets are tied at the hip even if bank liquidity rules don't recognize this. We thus review the new inter-agency Treasury-market report for its agency impact at a time of growing bond-market volatility. As our in-depth analysis of the new report makes clear, we had to look hard for near-term implications and, after doing our best, came away largely empty-handed.

Impact

The Inter-Agency Working Group on Treasury Market Surveillance didn't get its hands-off name for nothing. Although it comprises of senior staff from Treasury, the Fed, the Federal Reserve Bank of New York, the SEC, and CFTC, the Group's report is almost entirely non-committal except when it comes to over-arching reform principles and an updated list of all the data regulators have long said they need to know what's up in this critical arena. The nearest thing to substantive structural-change recommendations comes by what is said about central clearing – largely good – and how little is said about the big-bank supplementary leverage ratio – politically toxic.

The report also tips its hat – if not also its hand – to the need for Treasury-market broker-dealer registration with the SEC, but it goes on to argue that like-kind activities do not necessarily require like-kind regulation if the entity engaged differs from the banks for which regulation appears to set the default case. Global regulators and the Fed have long espoused a like-kind/like-mind rule, but the turf wars among all of the agencies that signed onto this report clearly preclude a unilateral approach to the U.S. Treasury market that will make substantive change still more of a struggle.

Outlook

The inter-agency report also has no timeline for action beyond discussion at the November 17 public-private conference on the Treasury market. FSOC is also set to discuss the report at a closed meeting next Monday, perhaps adjudicating at least a few inter-agency disputes and prioritizing specific ideas contained in the workstreams outlined in the report. The data initiatives will move the fastest because, for all the demands they make of the entire financial market, they lack business-model impact and are thus the easiest to advance. FSOC may also take a stand on the choice between central clearing and all-to-all trading, but we doubt anything near-term will happen on this critical issue until broader questions about CCP liquidity under stress and collateral transformation are addressed in separate

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global and inter-agency projects. SLR modification is on a very, very back burner at least until the Powell nomination is decided and even then, not until he is confirmed, should that prove the case.

Of course, this turf-warfare-as-usual scenario could get a rude comeuppance if Treasury-market liquidity takes a systemic turn for the worse. News suggests time may not be on a deliberative process' side.

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