# FIA PTG Response to the Joint Staff Report on the U.S. Treasury Market on October 15, 2014

*October 15, 2015*

## Recap of the Findings of the Report

As active market participants in U.S. Treasuries and related markets, the members of the FIA Principal Traders Group (FIA PTG)[1] appreciate the regulatory staff effort to produce a coordinated, data-driven analysis of the events of October 15, 2014. As the Report indicates, principal traders now account for the majority of trading and the "vast majority" of market depth in the multilateral, platform-based Treasury markets.[2] The principal traders that comprise FIA PTG's membership strongly support transparency, access, liquidity, and efficiency across all Treasury markets, including the Dealer to Dealer and Dealer to Customer markets.

The Report—compiled by representatives from the U.S. Department of the Treasury (Treasury), the Board of Governors of the Federal Reserve System (Fed), the Federal Reserve Bank of New York (NY Fed), the U.S. Securities and Exchange Commission (SEC), and the U.S. Commodity Futures Trading Commission (CFTC)—was constructed using transaction-level analysis of order book data from multilateral platforms during the period in question. We also appreciate that this Report examines the events of October 15th within the broader context of the long-term evolution of the Treasury markets. The Report recognizes the significant changes to the structure and composition of the markets that have occurred in recent years, and this provides a meaningful framework for analyzing individual market events.[3]

This Report's methodology is, in many ways, as important to market participants as the Report's conclusions are; because of the complex, interrelated nature of our markets, it is critical that discussions of market structure are based on this type of detailed, quantitative analysis.

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[1] FIA PTG is an association of more than 25 firms that trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated, and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. FIA PTG advocates for open access to markets, transparency, and data-driven policy.

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[3] We also believe it is important to highlight that the Report was unable to analyze and assess the impact of the sizeable activity that took place in the Dealer to Customer markets primarily due to the inability to readily obtain comprehensive data regarding that activity.

The Report concludes that a variety of factors, in aggregate, likely contributed to the increased volatility on October 15th, rather than any single factor. Importantly, the Report also notes that principal traders continued to provide liquidity and maintain tight bid-ask spreads, even during the period of unusually high volatility, while at the same time engaging in sensible risk management practices.

While some liquidity providers temporarily withdrew from the market on October 15th, principal traders generally continued to participate, remaining engaged on both sides of the market and preserving continuous pricing.

## Overview of Prior FIA PTG Work on Automated Trading and Risk Controls

Since its inception in 2010, FIA PTG has established itself as a thought leader in the area of automated trading and risk controls. Historically we have taken a collaborative, data driven and principles-based approach to our comments on automated trading and overall market structure. Our core tenets include:

- Broad-Based Risk Control Principles—Automated trading is used by a range of market participants, all of whom have a responsibility to implement risk controls appropriate to their role in the life of an order, whether that role is initiating the trade, routing the trade, executing the trade or clearing the trade. Risk control requirements should be principles-based so they can evolve with markets, technology and trading strategies.
- First, Do No Harm—Any regulatory effort to improve market infrastructure must, at a minimum, preserve the market quality improvements that have occurred as markets have become more automated and competitive.
- Encourage Innovation—Regulators should encourage industry efforts to protect markets through further innovation in risk controls and system safeguards.
- Data-Driven Decision-Making—Regulations should be supported by solid empirical evidence and rigorous economic analysis.

Recognizing that automated trading is a tool used by a wide variety of market participants, we have collaborated with exchanges, regulators, brokers, and traders to share expertise, consider best practices, and develop thoughtful guidelines for automated trading development and operation. A testament to our engagement on this issue is the fact that we have released six documents[4] on this subject in the last five years, most recently our response to the CFTC Concept Release and a Guide to the Development and Operation of Automated Trading Systems.

[4] Guide to the Development and Operation of Automated Trading Systems, March 2015; Response to the CFTC Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, December 2013; Drop Copy Recommendations, September 2013; Software Development and Change Management Recommendations, March 2012; Recommendations for Risk Controls at Trading Firms, November 2010; Market Access Risk Management Recommendations, April 2010

## FIA PTG Recommendations in Response to the Report

As was noted in the Report, electronic trading, much of it automated, has become an increasingly important component of the modern Treasury market. This growth in automated trading has been accompanied by concerns around managing the risks associated with computer-driven trading. FIA PTG supports the use of basic pre- and post-trade risk controls, including self-match prevention technology in the Treasury market, just as we have for many years in the futures markets.

In addition, we believe there should be more data transparency in the Treasury market. A thorough analysis of Treasury market structure and liquidity should include data from all relevant trading venues, including Dealer to Customer venues, non-multilateral platforms, multilateral platforms, and Designated Contract Markets. Any report that reviews the structure of the Treasury market should contain information regarding all major participants in that market.

### Risk Controls for Automated Trading

Multilateral Treasury platforms are subject to risk management controls for brokers or dealers with market access in accordance with SEC Rule 15c3-5, and these risk controls were in place on October 15, 2014. Furthermore, the report did not identify failed risk controls as a factor during the market events in question.

Nevertheless, as the Report noted, "in recent years, many trading platforms and firms have improved their risk management practices to better align with the faster trading environment, often aided by best practices drafted by industry or public bodies."

FIA PTG has supported such improvements, as detailed below:

#### *Pre-Trade Risk Controls*

Pre-trade risk controls can be implemented at various points in the order flow (trading platform, broker or individual trader) and at various levels of aggregation (trading platform, firm, account or individual trader). We believe the use of the following controls provide significant protection to the marketplace:

1. Maximum Order Size
2. Platform-based Dynamic Price Collars
3. Message Throttles

### *Post-Trade Analysis*

Drop Copy affords market participants the ability to have a trade reconciliation feed independent of their trading systems. Many platforms already provide Drop Copy feeds to their market participants as part of their suite of risk management services. While real-time delivery is ideal for optimal risk management, there may be extenuating circumstances that cause minor delays in the delivery of such information.

### *Self-Match Prevention*

FIA PTG believes it is important to understand that there is a clear regulatory distinction between unintentional self-match trades and intentional, manipulative (and illegal) wash trades.

Intentional wash trades are illegal self-matches that can manipulate markets by giving the impression of legitimate trading interest or activity at a certain price, time, and size. FIA PTG supports efforts to prohibit this activity.

There are also two forms of self-matches that can occur unintentionally:

1. One type is part of legitimate price discovery in a competitive marketplace, and it occurs when trades from different units within the same firm happen to cross each other. This can happen when independent decision makers initiate trades for legitimate and separate business purposes without knowledge of the other's order.
2. The other type occurs when, despite good faith efforts to avoid self-matching, trades from the same trading desk or unit are matched. This is due in part to the technical and operational limits of today's matching engine technology.

FIA PTG supports controls that help to prevent inadvertent self-matches, which we noted in our comments to the CFTC in response to their Concept Release on Risk Control and System Safeguards for Automated Trading Environments. We also support the development and enhancement of self-match prevention technology by exchanges and other market centers, which we expect will ultimately be effective in significantly reducing the number of inadvertent self-matches without hindering legitimate trading.

## Increased Transparency

### *Regulators' Access to Data*

The importance of coherent order and transaction data for regulatory monitoring, surveillance and analysis is repeatedly highlighted by the Report. One of the many benefits of automation is that it creates a clear and accessible record of all order and trade activity on a given trading platform. Such transparency—a characteristic of well-functioning markets—should be considered as regulators evaluate Treasury market structure and liquidity.

Prior to imposing new requirements, regulators should first take an inventory of all existing data pertaining to the auction and trade lifecycle within the Treasury market. Much of the data necessary to better analyze the Treasury market may already exist at the platform, clearing firm/prime broker, or, in the case of interest rate futures, at the relevant exchange. Once the data from the various different sources is identified, the next step should be to aggregate it in a manner that preserves temporal relationships across markets.

### *Publicly Available Data*

FIA PTG agrees that transparency around trading activity in the Treasury market is critical to investor confidence. However given the structural differences in the way these products trade, along with differences in pre- and post-trade reporting, especially between futures and Treasury cash securities, it is not surprising that the level of publicly available information is often not consistent across Treasury market venues or products. FIA PTG supports the proposed plan to conduct an assessment of the sufficiency of publicly available trade information.

## Conclusion and Future Considerations

The Report and the conversations that it has prompted are the first steps in what should be an objective and data-driven analysis of Treasury market structure and how it has evolved in the recent decade. We agree with the Report—before any changes can be made to a market as critical as the U.S. Treasury market, additional analysis is necessary.

Further analysis must take into account all aspects of what is now a complex, highly interconnected Treasury ecosystem. Some specific areas that merit further investigation may include:

- Increases in the cost of inventorying Treasury contracts, and how they have impacted traditional Treasury dealers, clearing firms, and prime-brokers.
- The introduction of new Treasury trading venues and how they may change market transparency, concentration, and complexity.
- The impact of technology and increased transparency and how they have enabled new market participants to provide liquidity and connect previously disjointed pools of Treasury liquidity.

FIA PTG supports orderly, transparent and competitive markets. We appreciate the opportunity to comment and look forward to contributing to policy discussions on improving Treasury market structure.