



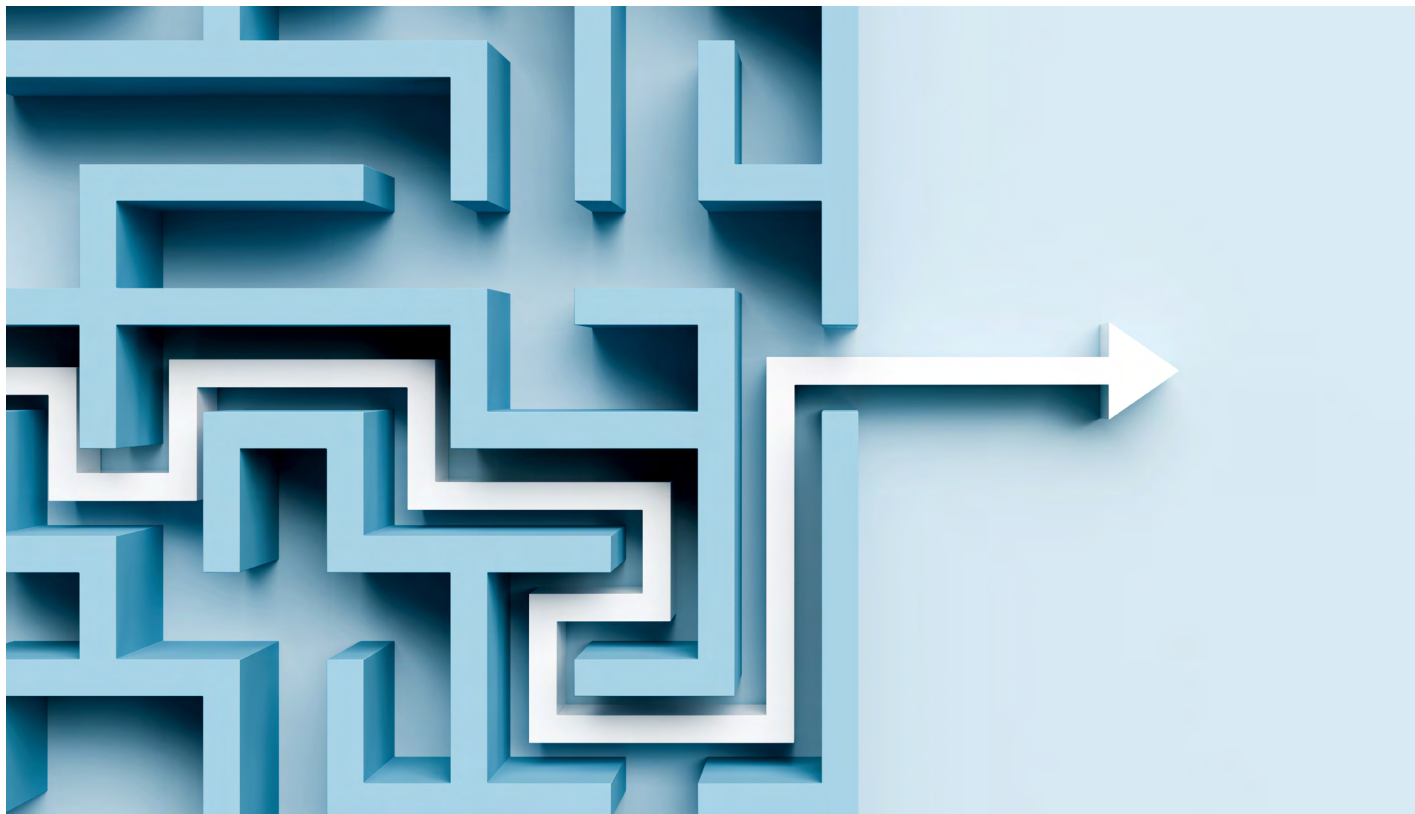
Investing in resilience

BNY's Nate Wuerffel on US Treasury clearing, the world's largest and most liquid sovereign bond market, and its global implications



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Investing in resilience: Navigating the US Treasury clearing mandate

Nate Wuerffel, head of product for Global Collateral and head of Market Structure at BNY, provides a comprehensive perspective on the US Treasury market and the upcoming clearing mandate that is set to impact not only the US, but Asia and Europe also. Carmella Haswell reports

The central clearing rule is set to transform the US Treasury market. How prepared are firms, and what impact will this have on international banks and buy side firms?

The Securities and Exchange Commission (SEC) clearing rule will reassemble the functioning of the US Treasury market — the world's most important sovereign bond market. The Treasury market's roots trace back to Alexander Hamilton, the forefather of the modern Treasury market, who emphasised the essential qualities such a market

must embody: safety and liquidity. Those defining characteristics have helped establish the Treasury market as the bedrock of the global financial system, underpinning capital markets, financing activity, and liquidity worldwide.

The Treasury market has experienced a number of periods of market illiquidity, prompting both the public and private sectors to take steps to strengthen its resilience. Among the most significant is the SEC's move to require mandatory clearing for eligible Treasury market transactions.

Central clearing is intended to reduce counterparty credit risk and, by extension, systemic risk in the market. It achieves this by placing a central counterparty (CCP) between the buyer and seller in a trade. Instead of being exposed to one another, firms face the CCP, which is intended to guarantee the transaction and ensure settlement is completed. In doing so, central clearing reduces the risk that either party fails to deliver securities or cash on time.

Because the majority of the Treasury market today is not centrally cleared, implementing the mandate is a significant change management effort. It requires change to counterparty relationships, risk management, margin and capital, systems, legal documentation and more. Fortunately, the original timelines were extended by around a year, with revised deadlines at the end of this year for US Treasury purchase and sale transactions. US Treasury Repo market transactions need to be cleared by the end of June 2027.

The industry has been making a tremendous amount of progress on readiness. BNY recently conducted a survey where about half of the respondents said they are very confident they will be able to comply with these new, revised target deadlines, while a further 40 per cent said they were somewhat confident that they would be able to comply with those deadlines.

In general, US firms appear to be further along in their preparations than those in Europe and in Asia. The survey results also suggest that sell side firms are generally better positioned for central clearing than some of their buy side counterparts. Each firm needs to do its own assessment of how it will prepare and those preparations should be well underway by now.

Repo transactions will be required to clear through a covered clearing agency by 30 June 2027. What uncertainties or challenges are yet to be tackled by the market to enable a smooth transition?

There are three key areas where uncertainties and challenges remain. Firstly, there are different provisions of the SEC clearing rule that

require the clearing of certain inter-affiliate transactions.

In the final rule, the SEC responded to market feedback to allow transactions between a member of a Covered Clearing Agency (CCA) and their affiliate to remain outside of the clearing rule, because such transactions are often done for liquidity and collateral management reasons. However, that exemption is conditional. If an affiliate enters into additional outward-facing transactions with clients, those trades must then be centrally cleared. The SEC wanted to avoid firms restructuring their repo activity and moving it to affiliates in order to avoid the clearing rule.

The industry has asked for additional flexibility to allow affiliates to do a small portion of their activity on a non-centrally cleared basis. The view is that firms should not have to devote a large share of their resources to set up clearing a relatively small portion of their activity through affiliates that might be difficult to clear for operational or legal reasons, or because some clients are difficult to bring into central clearing. Some flexibility there could be helpful.

Another aspect of the rule that has garnered attention is its global nature, or 'extraterritorial' reach. The Treasury market is a global one, with market participants trading in the market in many different jurisdictions. The mandate requires central clearing of eligible transactions, irrespective of jurisdiction, or the type of firm that is engaging in the eligible activity with few exceptions. This makes sense, because a safe and liquid Treasury market benefits from having a consistent set of rules regardless of where you participate in the market.

There have been calls for greater flexibility in the treatment of transactions involving non-US counterparties. In cross-border and foreign-jurisdiction contexts, clearing certain trades can be more complex, whether because of time-zone differences or because some legal entity structures are more difficult to accommodate. A measured degree of flexibility for transactions involving non-US entities could therefore be beneficial, provided it is applied in a consistent and even-handed manner, without creating opportunities for evasion or an uneven playing field.

The second issue is around the development of a done-away clearing model. In the US Treasury market, the executing dealer would typically also clear the trade, meaning execution and clearing take place together — what is known as a done-with transaction.

By contrast, in derivatives and certain other markets, execution and clearing can be separated, allowing a trade to be cleared away from the point of execution.

In market parlance, a done-away transaction is about separating the clearing and execution of a transaction. There may be firms that are well positioned to execute trades, and some that are well positioned to clear trades — those firms may not be the same.

At some point, there may be efficiencies if firms, who are comparatively well positioned to execute, can hand off the clearing of that trade to a firm that has more capital or margin efficiency and is able to clear transactions — that could broaden access within the US Treasury market to central clearing.

We have not seen that done-away clearing model develop yet, but over time we could see dealers face clearing capacity constraints, either because they run out of capital or margin funding capacity to clear their client activity. In that case they may want to turn to a third party that can clear trades with their clients so that they can continue to execute.

As we get closer to the deadlines, we might see some of the done-away clearing models evolve. Done-away clearing is something we can support in our BNY triparty infrastructure for any third-party clearing agent. We are also planning to create a done-away clearing agent service ourselves at BNY, acting as a third-party clearing agent for those using our triparty platform.

The third and final development is the innovation in clearing models that is happening, including as two new Treasury market CCPs launch. The Fixed Income Clearing Corporation (FICC) is the existing US Treasury CCP, and both CME and ICE have been approved as CCPs



“As we get closer to the deadlines, we might see some of the done-away clearing models evolve, and it is something that we are looking at closely here at BNY.”

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Head of product for Global Collateral and
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and are building out models to be able to clear. We are going to see some innovation in the Treasury market in terms of clearing, and market participants will be very interested to see those models and how they compare to the existing clearing models.

What type of clearing models are available for market participants to comply with the mandate and what kind of factors are driving decision making on which ones to use?

Central clearing is a bit like paying insurance. You are paying an insurance premium for times of stress when a counterparty might back away because of counterparty credit risk. In a centrally cleared trade, you pay that insurance premium on every single transaction to the CCP because the CCP is going to guarantee that such transaction settles. That insurance premium is based on the clearing model that the CCP is offering, and it includes everything from capital requirements for membership, liquidity commitments, and margin.

How can you offer a clearing model that is safe and effective, but also capital efficient and margin efficient? Over the last two years, we have started to see the evolution and innovation in clearing models to develop more capital and margin efficient models that are still safe.

FICC offers a number of different models; one of them is the Sponsored Member clearing model which is used widely within the market. That is a model that requires gross margining, so it tends to require more margin than some of the newer models. For example, Collateral-in-Lieu (CIL) is a second iteration of the Sponsored Member model that allows the CCP (FICC), to have a lien on collateral within BNY's triparty infrastructure. Its ability to take control of those assets means that the model helps protect trade participants in the event of a default while also supporting guaranteed settlement. As a result, it removes the sponsoring member's obligation to guarantee their client's performance, and in most circumstances, alleviates the need for FICC to collect margin for the client's side of the trade. This results in significant margin

and capital savings for the sponsoring member. I think that is going to be a very widely used model, because it is much more efficient. It addresses the double margining problem, wherein a sponsoring member both provides collateral to the collateral receiver and provides initial margin to FICC for the same trade.

FICC has also rolled out another model, which is the Agent Clearing Service, which enhances margin efficiency by permitting net margining across clients within the same omnibus account. What we hear today is that most market participants are thinking about how they get ready for day one compliance. So, we may see market participants adopt the models they are more familiar with, like sponsored and CIL, and then consider other models, including across CCPs.

What type of role is BNY playing in supporting the market's transition to central clearing?

BNY has played a central role in the Treasury market. We made the first loan to the US government over 235 years ago, and we have been involved in the US Treasury market since its inception. Today, we offer a full suite of services to the US Treasury market, including sales and trading, custody, settlement, financing, and beyond. Given the scale of the transformation under way in the Treasury market, we see it as important — and, in many respects, a responsibility — to provide services that support market participants as they adapt to the SEC's clearing mandate and move towards compliance.

The offering is structured across four key areas, each designed to support clients at different stages of their central clearing journey.

First, for firms that require pure clearing capabilities, BNY provides outsourced clearing services, enabling clients to delegate their Treasury clearing activity and execute transactions on a centrally-cleared basis in line with regulatory requirements.

Second, the proposition extends to centrally-cleared financing,

where counterparties can access direct financing from BNY. For example, clients seeking to centrally clear repo transactions can do so while benefiting from integrated financing alongside compliant trade execution.

A third area is the Global Collateral platform, which supports triparty and other financing transactions within a centrally-cleared framework. The ambition is to establish the platform as a global hub, enabling CCPs to integrate and allowing market participants to conduct centrally-cleared transactions while managing margin requirements efficiently. By facilitating the intake of transactions and their novation to CCPs, and delivering real-time visibility into transaction status, the platform supports a more streamlined and transparent clearing process.

Within this ecosystem, FICC is already integrated, providing access to services such as CIL, Agent Clearing Service, Sponsored GC, and inter-dealer financing through the GCF Repo Service. In parallel, integration efforts are underway with ICE and CME, further expanding the scope of centrally-cleared activity supported by the platform.

The fourth area focuses on margin management and optimisation, supporting CCPs and their members in meeting collateral obligations. Through the Global Collateral platform, participants can allocate and optimise collateral across multiple exposures within a single infrastructure, creating a more efficient framework for deploying assets across centrally-cleared and non-cleared activity.

Overall, we have a comprehensive set of solutions for the marketplace and are looking forward to working with clients to help get them through the transition to mandatory clearing.

Looking forward, what trajectory will the US Treasury market take over the next three to five years?

The US Treasury market is the most important sovereign bond market, and there has been so much emphasis on ensuring its resilience

over time to continue to support its safety and liquidity. It is a growing market. Today it is about US\$30 trillion in size, but the congressional budget estimates say it will grow to be over US\$50 trillion in the next 10 years.

As the Treasury market continues to grow, it will demand more from its participants in terms of intermediation, liquidity, and risk absorption — reinforcing the need for continued improvements in transparency, risk management, and overall market resilience.

We will continue to see the public and the private sector investing in the resilience of the market. Central clearing is one piece of that, but there are a lot of other avenues that need to be pursued.

At the same time, we are seeing that technology is changing in a way that is transforming the Treasury market. Distributed ledger technology (DLT) is helping the marketplace move towards 24/7 trading, financing, settlement, custody — that is the direction of travel in financial markets at large, but also in the Treasury market. AI is also starting to transform financial markets; that is likely to be seen in the US Treasury markets as well.

In the next three to five years, there will be continued efforts to bolster the resiliency of the Treasury market. All of the public agencies — the Treasury, the Fed, the SEC, and the CFTC — are involved in these efforts. That is a priority on the private side as well, because the Treasury market is relied upon for so many things — it is a safe haven for investing, it is a foundation for pricing most of the capital markets instruments, and it can be a port in a storm of volatility.

Looking ahead, ensuring the continued strength of the Treasury market will require sustained commitment from both the public and private sectors. Central clearing is one important step, but the broader goal is clear: to build on the market's enduring foundations and ensure it remains the world's benchmark for safety, liquidity, and resilience. ■