BETTER MARKETS

SEC

FACT SHEET

Policymakers Must Bolster the Treasury Market

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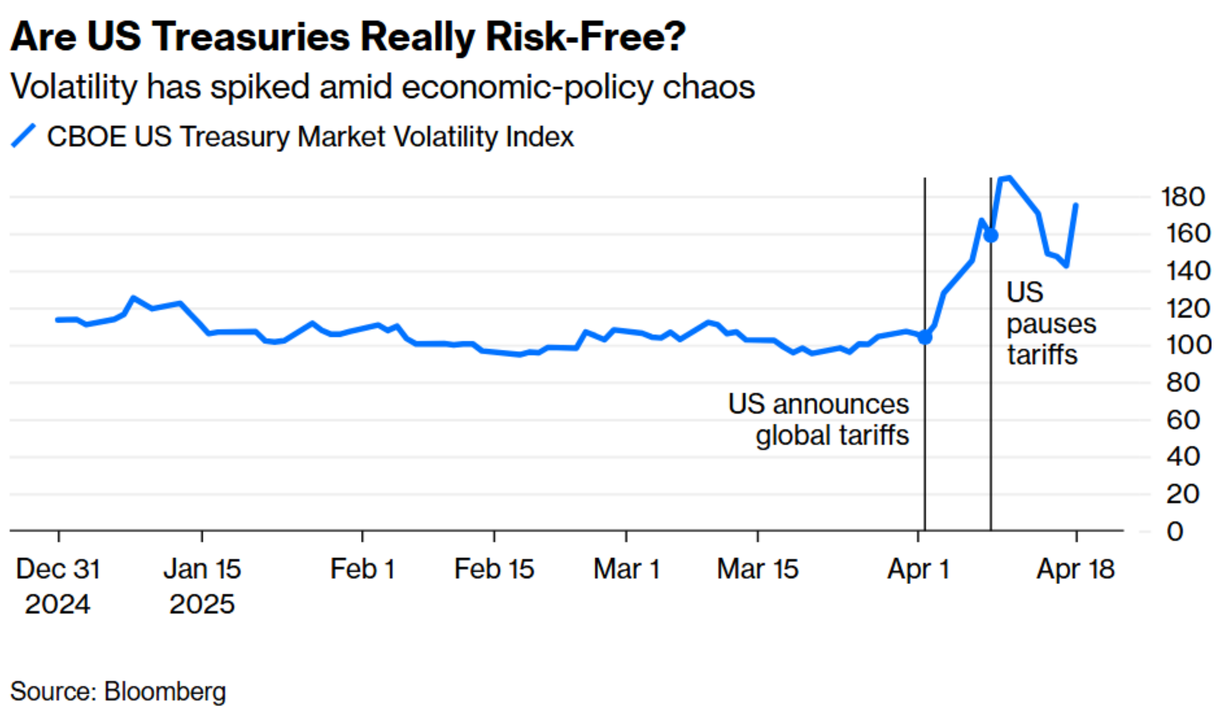
The U.S. Treasury market isn't sexy. It doesn't garner the attention that stocks, exchange-traded funds, and cryptocurrencies command, but it is more important than them all. That is because the price of Treasuries helps set interest payments for mortgages, credit cards, car loans, and almost any other type of consumer borrowing. Many banks and financial firms also hold Treasuries as a hedge against other assets perceived to be more volatile. Indeed, the market for Treasuries has long been deemed one of the safest and most stable in the world, which makes it the bedrock of the global financial system.

The assumption that the Treasury market is a safe haven, however, has recently been called into question. The administration's tariff policies have led investors to lose faith in America as a stable, predictable, and secure place to store their money. This raises the question of whether U.S. Treasuries are really as risk-free as we believe them to be.



The tariffs announced last month caused investors to start pulling money out of U.S. Treasuries. This caused the yield—the interest rate on Treasuries—to spike. It looked like this could lead to a rush to liquidate assets, which would be akin to a bank run on the entire global financial system. Although the Treasury market eventually stabilized and we avoided an economic calamity, the episode serves as a reminder of the importance of safeguarding the Treasury market. One of the main drivers of the episode was poor liquidity—the ease with which investors can buy and sell Treasuries without moving prices. The market's ability to absorb large trades without significant shifts in price worsened during the upheaval, which meant even small trades were moving yields significantly.

Liquidity is a crucial measure of how well the Treasury market is functioning. As a result, it is essential that we adopt rules to ensure that investors can transact when needed at low cost without materially moving the price, both in normal times and in periods of stress.

The Importance of the Treasury Market

On March 15, 2025, the House Financial Services Committee will hold a hearing entitled "Examining Treasury Market Fragilities and Preventative Solutions." The hearing is unlikely to capture the public's attention. But given that the Treasury Market is $28 trillion, it is essential that policymakers take the steps necessary to bolster the market.

The Treasury market must be safeguarded because everyone holds Treasuries:

> Treasury securities provide a real-time measure of global confidence in the US and its economy. They've long been considered so safe that they serve as the "risk-free" benchmark for valuing tens of trillions of dollars in stocks, bonds and other investments worldwide. In times of distress, investors have tended to flock to the haven of Treasuries, driving prices up and yields down.

So a resilient Treasury market is important because "everyone, from pension funds to foreign governments, puts their money into the market for safekeeping, making it the world's de facto borrowing benchmark." This makes the market critical to worldwide financial stability. And it means that "any sustained problems or a collapse in prices would have global consequences, ricocheting through stocks, corporate bonds, and currencies."

The Fragilities of the Treasury Market

Despite the importance of the Treasury market and the potentially catastrophic consequences if it collapsed, it remains dark and underregulated to a staggering degree.

> Trading in Treasuries is opaque, and information about positioning, especially among non-banks, is hard to come by.

The role of non-banks has also contributed to liquidity concerns. Liquidity has worsened over the last few years. After banks retreated as liquidity providers in the Treasury market following the financial crisis, and high-frequency traders and hedge funds took their place, liquidity deteriorated as the market grew.

The changing composition of liquidity providers has also seen liquidity evaporate at crucial moments. Indeed, there have been periods of instability in the market where high-frequency traders pulled back from providing liquidity. The fact that hedge funds and high-frequency traders are not providing the kind of liquidity in times of stress that banks did can exacerbate crises, such as during the 2020 market meltdown. Then, liquidity in most Treasuries vanished, forcing the Fed undertake massive asset purchases and other measures to avoid a collapse. So policymakers must grapple with the fact that hedge funds and high-frequency traders have little incentive to trade in times of stress.

The SEC's Proposals to Bolster the Treasury Market

This is why, during the Biden Administration, the SEC proposed three rules that were designed to help bolster the state of the Treasury market.

Central Clearing

One rule, which the SEC adopted in 2023, required more Treasury market trades to be centrally cleared. This meant that more trades in the Treasury market would have to be guaranteed by a third party, and the participants to the trade would have to have more cash on hand to place the trades.

The idea is that a clearing house stands between a buyer and seller and prevents failed trades from cascading through the market.

The upshot is that central clearing would allow market participants to more effectively manage risk and mitigate the potential for a single market participant's failure to destabilize the financial system. That is why Nellie Lang, Under Secretary of the Treasury for Domestic Finance during the Biden Administration, has said:

> The SEC's rule for central clearing of Treasury securities is potentially the most significant and transformational to the Treasury market.

Despite the rule's importance, after the change in administration, the SEC extended the compliance dates for the rule, so that the rule will not take effect until the end of 2026 for some Treasury trades and mid-2027 for other types of Treasury trades. The rapid implementation of the rule would have reduced the risk in the U.S. Treasury securities market. Conversely, the longer that market participants need not comply with these rules, the greater the chance that a disruption in that market will lead to a financial calamity.

Registration as a Dealer

A second rule, which the SEC adopted in 2024, addressed the fact that high-frequency traders and hedge funds had become liquidity providers. Because these traders were less regulated than the banks which provided liquidity previously, the SEC proposed to regulate their activities in the Treasury market in similar ways to banks. The final rule required high-frequency traders and hedge funds with significant liquidity-providing roles to register as a dealer with the SEC, which meant that they would have to be more transparent about their positions and trading activity and hold a greater amount of capital to back their deals.

Unfortunately, after hedge funds challenged the rule, a federal district court struck it down. Although the SEC initially appealed that decision, it withdrew the appeal after the change in administration. So although the impetus for the rule was the increasingly important role played by high-frequency traders and hedge funds in the Treasury market, and although that role continues today, the SEC determined that regulation was no longer necessary.

The central clearing and dealer rules, which were designed to fix the structural issues causing liquidity problems in the Treasury market, represented "the biggest overhaul of the Treasury market in decades." But the SEC has now extended the compliance dates for the central clearing rule and assented to the industry challenge of the dealer rule. So, at least for the foreseeable future, the risks that prompted both rules remain unaddressed.

Regulation of Treasury trading platforms

The SEC also proposed a third rule to regulate largely unregulated trading platforms that trade Treasuries. Because these platforms did not qualify as securities exchanges and were exempt from the rules governing alternative trading systems (ATSs), they were not subject to the same investor protection and fair and orderly market principles that applied to exchanges and ATSs. The SEC's proposal was designed to fill this regulatory gap.

In doing so, the proposal would have promoted resiliency in and greater access to the Treasury market. Our comment letter noted that it would have brought "much needed oversight and investor disclosure to the $21 trillion Treasury securities market" through greater transparency, fairer competition, and stronger investor protections. Even the lone SEC Commissioner who dissented from the proposal, largely on procedural grounds, found the proposal to be reasonable:

> The proposed rules would bring venues that facilitate the trading of government securities . . . within our regulatory ambit, effectively forcing these venues that make these securities available for trading to become ATSs . . . which should help market participants better understand where and how they can trade these securities. The rules . . . also . . . could ensure access to liquidity for a larger proportion of market participants. Because more venues would be operating as ATSs, trades executed on these venues would be reported to TRACE [the Trade Reporting and Compliance Engine], which should increase transparency in the market.

Unfortunately, the SEC did not adopt the proposal before the change in administration. The SEC's new leadership should move expeditiously to adopt the Treasury market reforms in the proposal. And if Congress is serious about "examining Treasury market fragilities and preventative solutions," it should also consider the importance of regulating the platforms that trade Treasuries today.

Conclusion

It is important to remember that there will be real economic consequences to ordinary Americans if Treasuries lose their status as a safe haven during market volatility. Normally, investors seek shelter in Treasuries in times of market chaos and yields fall as a result. However, during last month's upheaval, treasury yields rose. And when yields climb, so do rates on many other consumer products, such as auto loans, credit cards, and mortgages. So the Treasury market, despite its complexities, matters to consumers. Policymakers must do everything possible to safeguard the Treasury market to shield consumers from unnecessary volatility, protect investors, and preserve the global financial system.

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Better Jobs | Better Economic Growth
Better Lives | Better Communities

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

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