ISDA Safe, Efficient Markets
Celebrating 40 Years

**Testimony of Scott O'Malia**
**Chief Executive Officer, International Swaps and Derivatives Association**
**Before the**
**U.S. House of Representatives Committee on Financial Services**
**Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity**
**April 8, 2025**

Chairman Lucas, Ranking Member Vargas, and Members of the Committee, I'm grateful on behalf of ISDA for the opportunity to submit testimony on the structure of the U.S. Treasury market, and to outline steps that should be taken to ensure its continued vitality.

The U.S. Treasury market is the deepest, most liquid market in the world. It is the oil that keeps the wheels of the global financial system turning and is the primary means by which the U.S. government raises funding. More specific to derivatives, the Treasury repo market supports the exchange of collateral, which is a foundational element of the post-crisis reforms. Without a cost-effective and liquid repo market, we would compromise the timely delivery of margin for cleared and non-cleared derivatives trades. This would severely impact asset managers, pension funds, insurance companies, and other firms that use the repo market to exchange invested securities into eligible collateral. It is therefore critical that this market continues to function safely and efficiently.

ISDA commends the Committee for its leadership in examining the resiliency of this market, particularly given important structural changes that will soon be forthcoming. This includes the introduction of mandatory clearing requirements for U.S. Treasury cash and repo transactions. ISDA supports clearing in the U.S. Treasury market and, towards this end, I will outline several important reforms that are required to ensure clearing is successful and the U.S. Treasury market remains deep and liquid.

As outlined in my testimony, ISDA believes several critical issues need to be resolved to safeguard the robustness and resilience of this vital market.

Specifically:

1) Prudential regulators must address issues with the design and calibration of the **supplementary leverage ratio** (SLR) to ensure banks have the balance sheet capacity to provide intermediation and client clearing services in the U.S. Treasury market, including during periods of stress.
2) The proposed Basel III endgame and surcharge for global systemically important banks (G-SIBs) must be revised to **remove an unnecessary and disproportionate tax on clearing**, which would increase capital for G-SIB client clearing businesses by more than 80%.
3) The margining and capital treatment of client exposures must be revised to reflect the actual risk of a client's overall portfolio. This means allowing firms to realize the benefits of cross-margining for U.S. Treasury securities and futures and recognizing corresponding offsets in the U.S. capital framework.

4) Finally, when it comes to the clearing mandate itself, the Committee should continue to review the **timelines** as the industry progresses with implementation. While clearinghouses and market participants are working to address the various operational, legal and regulatory issues, such as developing and testing new client clearing models and drawing up new documentation, we know from our experience with derivatives clearing and margining of non-cleared derivatives that these issues take time to resolve, particularly given the global reach of the rules. There are no short cuts.

Now is the time to revisit these issues to give clearing the best chance of success and to maintain the depth and liquidity of the U.S. Treasury market.

**Background**

With outstanding issuance of nearly $30 trillion, the U.S. Treasury market is the world's biggest and most systemically important market. Its depth and liquidity attracts investors around the globe, enabling the U.S. government to raise the funding it needs. It also underpins the global financial system – the U.S. Treasury repo market is the basis for secured dollar funding globally and serves as collateral for hundreds of millions of dollars' worth of derivatives used by banks, companies, pension funds, and insurance companies to hedge their risks.

At a time when Treasury issuance is at record highs and is forecast to rise to $52 trillion by the end of 2035,[1] it is right that U.S. policymakers focus on ensuring this market remains robust and resilient, even during periods of stress.

The Securities and Exchange Commission (SEC) has determined that mandatory clearing is part of the answer. This is one component of a program of work to improve U.S. Treasury market resilience following a series of stress events, including the dash for cash in March 2020. Proponents say broader clearing of U.S. Treasury securities will help reduce settlement risk, enhance risk management practices, and increase transparency in this critical market.

Under rules finalized by the SEC in December 2023,[2] clearing agencies would have had to adjust their policies and procedures to require their members to clear certain cash U.S. Treasury securities by December 31, 2025, with repos following in a second phase six months later – a requirement that would significantly increase the volume of U.S. Treasury transactions required to be cleared.

Following concerns about the extraordinarily short time frame to make these fundamental changes to market structure, the SEC announced in February 2025 that it would delay implementation by one year.[3] That means eligible cash transactions will now need to be cleared by December 31, 2026, with repos following from June 30, 2027. This is a very

[1] Congressional Budget Office, Report: *The Budget and Economic Outlook*: *2025 to 2035*, January 17, 2025, www.cbo.gov/system/files/2025-01/60870-Outlook-2025.pdf

[2] 89 Fed. Reg. 2714-2830 (January 16, 2024); *see also* SEC Release 2023-247, *SEC Adopts Rules to Improve Risk Management in Clearance and Settlement and Facilitate Additional Central Clearing for the U.S. Treasury Market*, December 13, 2023, www.sec.gov/newsroom/press-releases/2023-247

[3] 90 Fed. Reg. 11134-11139, Mar. 4, 2025; *see also* SEC Release 2025-43, *SEC Extends Compliance Dates and Provides Temporary Exemption for Rule Related to Clearing of U.S. Treasury Securities*, February 25, 2025, www.sec.gov/newsroom/press-releases/2025-43

welcome extension that ISDA and other industry groups supported,[4] and we would like to thank the SEC for taking this crucial step. Among other things, the extra time allows for consideration of the intersection between the SEC's mandate and bank capital regulations.

Banks play critical roles in all segments of this market. Specifically, they serve as primary dealers in auctions of new U.S. Treasury issuances, trading counterparties to the Federal Reserve Bank of New York, and market intermediaries for banks and non-banks. These intermediation activities include providing access to cleared U.S. Treasury markets for clients – a role that will increase following implementation of the SEC's clearing mandate.

**Supplementary Leverage Ratio**

There are several policy reforms we believe are necessary to support and enhance the capacity of banks to participate in the U.S. Treasury market. The SLR is one such issue. As it stands, the SLR serves as a non-risk-sensitive binding constraint on banks that can impede their ability to act as intermediaries, particularly in times of stress. Because bank intermediation activities are high volume and low margin, these activities are "more sensitive to the SLR constraint than lending and other banking activities."[5]

At the height of the global pandemic in April 2020, concerns about bank intermediation capacity were serious enough to prompt the Federal Reserve to temporarily exclude U.S. Treasury securities from the SLR calculation.[6] Academics have also pointed to the role of the SLR in constraining the ability of banks to participate in the U.S. Treasury market in certain circumstances.[7]

Last year, I sent a letter to U.S. prudential regulators requesting that this exemption be reintroduced on a permanent basis,[8] a move we think would provide greater capacity for banks to expand their balance sheets and provide liquidity. There are other options regulators could consider, including the treatment of repos and central bank cash reserves and calibration of the SLR buffers. The SLR is not part of the Basel III endgame package, so we would urge the Federal Reserve to conduct a separate consultation to determine the best way forward.

We were pleased to hear Federal Reserve Chair Jerome Powell acknowledge in testimony before this Committee in February[9] that changes are necessary, as well as comments by

---

[4] ISDA, *Deadline Pressure on Treasury Clearing*, January 22, 2025, www.isda.org/2025/01/22/deadline-pressure-on-treasury-clearing

[5] Paul Cochran et. al., *Dealers' Treasury Market Intermediation and the Supplementary Leverage Ratio*, August 3, 2023, www.federalreserve.gov/econres/notes/feds-notes/dealers-treasury-market-intermediation-and-the-supplementary-leverage-ratio-20230803.html

[6] *Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio*, 85 Fed. Reg. 20578-20586, April 14, 2020, www.federalregister.gov/documents/2020/04/14/2020-07345/temporary-exclusion-of-us-treasury-securities-and-deposits-at-federal-reserve-banks-from-the..

[7] *See e.g.* Darrell Duffie, *Resilience Redux in the U.S. Treasury Market*, Jackson Hole Symposium, Federal Reserve Bank of Kansas City (August 29, 2023), www.kansascityfed.org/Jackson%20Hole/documents/9726/JH_Paper_Duffie.pdf

[8] Letter from ISDA to Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, *SLR Reform – U.S. Treasuries*, March 5, 2024, www.isda.org/2024/03/05/isda-submits-letter-to-us-agencies-on-slr-reform/

[9] Testimony of Federal Reserve Board of Governors Chair Jerome Powell, House Financial Services Committee, February 12, 2025, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409453

Secretary of the Treasury Scott Bessent[10] and Federal Reserve Governor Michelle Bowman[11] drawing attention to this issue.

We would be happy to work with regulators to arrive at a robust solution that balances the need for stability in the banking sector with the critical objective of maintaining deep and liquid U.S. Treasury markets.

**Basel III Endgame/G-SIB Surcharge**

A second capital-related issue is the impact of the U.S. Basel III endgame rules and the surcharge for U.S. G-SIBs. It has long been clear that these measures as currently proposed are inappropriately calibrated and would constrain the capacity of banks to offer vital intermediation and risk management services.

Nowhere is this more evident than central clearing. Analysis by ISDA and the Securities Industry and Financial Markets Association (SIFMA)[12] has shown that the proposed U.S. Basel III rules and the G-SIB surcharge would increase capital for U.S. G-SIB client clearing businesses by more than 80%. This punitive tax is completely at odds with the post-financial crisis policy objective to promote greater use of central clearing. It is not aligned with risk and would bring the economic viability of client clearing businesses into question at precisely the time when thousands of firms will be looking to banks to help them clear their cash U.S. Treasury and repo transactions.

We strongly believe the capital rules should be consistent, risk-sensitive, and appropriate. Disproportionate increases in capital will inevitably affect the ability of U.S. banks to offer client clearing services, reducing capacity and increasing costs. Ultimately, this will affect the depth and liquidity of U.S. Treasury markets.

The U.S. Basel III proposal will also make it more expensive to raise funding for meeting margin requirements on cleared transactions. That is due to the introduction of minimum haircut floors for securities financing transactions (SFTs), putting the U.S. at odds with other major jurisdictions like the EU and UK, which have opted not to enforce this requirement.

We have proposed several calibration changes to the U.S. Basel III and G-SIB proposals to better reflect actual levels of risk. These include changes to certain aspects of the rules for credit valuation adjustment and modifications to the complexity and interconnectedness categories of the G-SIB surcharge to reduce the impact on client clearing. We also proposed changes to certain aspects of the rules for SFTs, including removal of the minimum haircut floor.

We strongly encourage U.S. prudential regulators to go back to the drawing board and rethink this issue to avoid unnecessary and disproportionate capital increases that could hinder the

[10] Remarks of Secretary of the Treasury Scott Bessent, Economic Club of New York, March 6, 2025, https://home.treasury.gov/news/press-releases/sb0045; Interview with Secretary of the Treasury Scott Bessent, *All In Podcast*, March 19, 2025, www.youtube.com/watch?v=lSma9suyp24

[11] Federal Reserve Governor Michelle Bowman, Speech to the 2025 Wisconsin Bankers Association Bank Executives Conference, *Bank Regulation in 2025 and Beyond*, February 5, 2025, www.federalreserve.gov/newsevents/speech/bowman20250205a.htm)

[12] ISDA, *Capital for Clearing Must be Risk Appropriate*, April 15, 2024, www.isda.org/2024/04/15/capital-for-clearing-must-be-risk-appropriate/

ability of banks to clear U.S. Treasury transactions for clients and support deep, liquid markets.

**Margining and Capital Treatment of Client Exposures**

For efficient clearing of U.S. Treasuries by clients, the amount of margin posted and corresponding bank capital requirements must reflect the actual risk of client exposures across their entire portfolios.

Two key issues must be resolved to achieve this.

First, clients must be able to realize the benefits of cross-margining across U.S. Treasury securities and futures. Cross-margining programs have been a widely accepted part of cleared markets for two decades. They ensure that the amount of initial margin posted reflects the actual risk of a portfolio of trades, even if those trades are cleared at two separate clearinghouses. For example, the SEC and the Commodity Futures Trading Commission (CFTC) have approved cross-margining at the clearing-member level by the Fixed Income Clearing Corporation (FICC) and CME Group to enable initial margin efficiencies from offsetting trades in a portfolio of Treasury cash, repo, and futures transactions.

These clearinghouses have announced their intention to extend cross-margining to client transactions, subject to approval by the SEC and CFTC. It is critical FICC and CME Group finalize details of their client cross-margining program and the SEC and CFTC act quickly to approve it once they do.

The second issue is recognition of the risk-reducing benefits of netting across U.S. Treasury repos and futures in the counterparty credit exposure calculation under the U.S. capital framework. Without this recognition, banks will face elevated capital requirements as a result of higher exposures combined with reduced margin posted by clients under the cross-margining program.

In this scenario, a bank would either be forced to require a customer to post the full amount of margin – foregoing the benefits of cross-margining programs – or face a significant increase in capital requirements. This would reduce bank balance sheet capacity to facilitate the clearing of client Treasury transactions at a time when volumes of cleared trades will increase dramatically with the introduction of the SEC clearing mandate.

ISDA has proposed a potential fix that would involve treating repos on U.S. Treasury securities as forward-settling interest rate derivatives and determining the exposure at default of a portfolio of repos and derivatives contracts subject to a cross-product netting agreement under the standardized approach for counterparty credit risk.

This is a relatively simple solution that, together with the approval of client cross-margining programs, will make it much more efficient for clients and their bank intermediaries to clear increased volumes of Treasury repos.

This issue has been exacerbated by a proposal from U.S. prudential regulators to eliminate the option for banks to use internal credit risk models, which extends to counterparty credit risk. We are concerned about the withdrawal of more advanced internal models and the increased reliance on standardized approaches, which may not be suitable for all situations.

It is crucial this issue is resolved before the clearing mandate comes into effect, and we would be happy to discuss this with prudential regulators in more detail.

**Implementation of the SEC's Clearing Mandate**

ISDA and its members are supportive of clearing in the U.S. Treasury market. We agree that clearing can improve the safety and stability of financial markets. Indeed, ISDA and its members have worked hard to successfully implement clearing in the over-the-counter derivatives market. However, it is critical that market participants can implement the mandate in a manner that maintains efficiency in the U.S. Treasury market.

Significant progress has already been made to prepare for U.S. Treasury clearing. FICC – historically the only clearing house for U.S. Treasury transactions – released proposed changes to its rule book last year,[13] while CME Group has published proposals for a new clearing service. ICE has also announced it will launch a Treasury clearing service.

We understand that firms are clearing on a voluntary basis when they can, ahead of the clearing mandate. This shows that market participants do clear U.S. Treasuries when it is efficient to do so – a trend we expect to continue as regulators and market participants address outstanding legal, operational and regulatory issues.

As of this hearing, FICC offers direct clearing and a couple varieties of sponsored clearing. It has also proposed a new agency model to replace two of its historical clearing models that have not been widely used. In addition, CME Group has proposed a new clearing offering that would provide direct clearing plus two varieties of agency-like clearing. All entail different obligations for members and users and have varying implications for collateral segregation, accounting, and netting.

These models support so-called "done-away" clearing to various degrees. Done-away clearing is a new development in the U.S. Treasury clearing space, as clients have historically cleared via their executing broker. The change reflects the fact that certain buy-side firms would prefer to limit their clearing relationships but maintain the flexibility to execute U.S. Treasury transactions with a larger number of dealers, as is the case in derivatives markets. Clients need to do their homework to understand the implications of the various changes, and that work should be underway.

To assist the market, ISDA has published a comparison of various clearing models for U.S. Treasury transactions and derivatives, which we will update as new models emerge.[14] ISDA has also run multiple seminars and conferences on Treasury clearing to help market participants get to grips with the changes, and these educational efforts will continue as we approach the implementation date.

Alongside this work, SIFMA is leading an industry group that also includes ISDA, which is developing appropriate client documentation. Good progress has been made, but this

[13] ISDA, comment letter to the Securities and Exchange Commission, *FICC Proposed Rulebook Changes Related to Trade Submission Requirements*, August 6, 2024, www.isda.org/2024/08/06/isda-letter-on-ficcs-proposed-rulebook-changes/
[14] www.isda.org/2024/02/23/isda-clearing-model-comparison/

documentation needs to work for the various clearing models and rule books that are still being developed, as well as client segregation solutions, some of which have yet to be finalized or tested.

Dealers will then need to execute the new documents with thousands of counterparties, as well as obtain netting opinions in the U.S. and a number of foreign jurisdictions to ensure efficient capital treatment. We know from the implementation of the margin rules for non-cleared derivatives that this is a considerable amount of work that takes time. Those rules – which similarly involved the development of revised custodial models and the execution of new documentation – were phased in over six years, from 2016 to 2022. The important lesson from that experience was that there are no shortcuts – it takes time to do this properly.

That is particularly true given the potentially wide global reach of the requirements. As it stands, the SEC's mandate applies globally to any firm that trades with a member of a U.S. Treasury clearing agency. We are still analyzing the cross-border implications of this requirement, which involves examining non-U.S. laws and regulations on custody and transfer of assets, netting legislation outside the U.S. and various operational issues, including the ability to access clearing from a different time zone. We encourage the SEC to clarify the extraterritorial scope of its clearing mandate and ensure foreign counterparties continue to have access to U.S. Treasury markets.

We also encourage the SEC to act to avoid its regulations hindering implementation of the clearing mandate domestically. This means ensuring the inter-affiliate exemption is broad enough to facilitate prudent internal liquidity and collateral management, making clear that transactions meant to finance non-Treasuries are not subject to the mandate and confirming that investment managers do not have to post margin twice for repo trades. In addition, the SEC should allow pre-funding of customer margin with dollars and clarify the accounting treatment for broker-dealers when they clear for clients.

Given the pivotal role U.S. Treasuries play in the derivatives and financial markets, we need to make sure there is sufficient time to complete the necessary preparations and reforms in a way that protects the integrity of this vital market.

**Conclusion**

The U.S. Treasury market is systemically important and underpins the smooth functioning of markets globally, including adjacent derivatives markets. It is therefore critical that we look carefully at rules from the SEC, CFTC and prudential regulators to ensure they support – rather than impair – U.S. Treasury market liquidity and resiliency.

While we recognize the appointment of agency leaders under the new administration may take some time, there is no reason why staff cannot begin work on the SLR, G-SIB surcharge, and counterparty credit exposure now, even before the Basel III endgame is finalized.

Unless changes are made, bank balance sheet capacity will come under strain, threatening the ability of banks to absorb the massive supply of new Treasury issuance and facilitate client clearing. Disruption in the U.S. Treasury repo market could also impair the exchange of collateral for cleared and non-cleared derivatives.

We thank the SEC for recognizing the scale of the challenge and extending the deadlines by one year, but this will not matter unless changes are made in the regulatory framework to ensure additional clearing can be implemented without disruption. In particular, changes to the capital framework must be addressed in quick order to give clearing the best chance of success and to maintain the smooth functioning of the U.S. Treasury market.

The U.S. Treasury market is too important – both for the funding of the U.S. government and the global financial system – to make mistakes that threaten the liquidity of this market. It is vital we consider the impact of multiple rules in combination to make sure this market continues to function smoothly and efficiently. We must get this right.