



Henry Kaufman Management Center
44 West 4th Street, Suite 9-190
New York, New York 10012-1126
Tel: 212-998-0310
Fax: 212-995-4220
Email: jhasbrou@stern.nyu.edu
Joel Hasbrouck
*Kenneth G. Langone Professor of Business Administration
Department of Finance*

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Office of the Under Secretary for Domestic Finance
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Notice Seeking Public Comment on the Evolution of the U.S. Treasury Market Structure
Docket ID: TREAS-DO-2015-0013

To Whom It May Concern:

First, by way of full disclosure, in addition to my academic activities at NYU, I also teach finance at a firm that engages in a broad range of financial activities, including market making and high-frequency trading. My income from this activity is approximately ten percent of my NYU compensation.

My suggestions here are quite modest. They would simply push transparency and access in the U.S. Treasury market toward the current standards of most major security classes, including equities, exchange-traded futures and options, and corporate bonds. The suggestions are:

- Last sale reporting.
- An access rule, which would require trading platforms to accept and handle all orders on a non-discriminatory basis.
- An order protection rule, which would generally prohibit executions that would trade through existing bids and offers.

Basic transparency requires reporting of trades and current bid and offer quotations, consolidated across all platforms. This has long been the norm in equities markets, and was most recently affirmed in the SEC's Report of the Advisory Committee on Market Information (2001). It is also standard in futures and options. Corporate bonds (through TRACE) and municipal bonds (through the MSRB) have last sale reporting, subject to some large-trade censoring. The bids and offers in these last markets, though, are mostly indicative.

With respect to access and order protection requirements, experience in other markets is instructive. The introduction of last sale reporting in the corporate bond market was generally associated with improved liquidity (see the numerous academic studies posted at the FINRA/TRACE website). Further gains, however, are likely to require order access and protection measures. In equity markets, the order protection rule of Reg NMS was adopted after the SEC noted that, “an estimated 1 of every 40 trades [2.5%] in both Nasdaq and NYSE stocks represents a significant trade-through of a displayed quotation.”¹ In corporate bonds, a recent study puts the trade-through rate at about 43%.² In the absence of trade reporting, no corresponding estimate can be advanced for the Treasury market, but there is no reason to suppose that the rate would be much lower.

This suggests that bond investors need markets where they can post bids and offers that can be broadly displayed and protected against executions that, by trading through these prices, would effectively ignore them. The experience of equity markets suggests that requiring trading platforms to comply with these principles would encourage broad participation in the market, and lead to narrower bid-ask spreads.

Some market commentators believe that equity trading costs are low only for the smallest trades, and that costs for trades of institutional size have actually gone up. I am aware of no authoritative studies on this point, but if it emerges as a concern, there is a transition path. Trade reporting can be censored for large quantities (as is currently the practice on TRACE). If this exception is thought necessary to encourage dealer participation in the market, it should be subject to periodic review in controlled roll-out/roll-back studies.

The benefits of a more transparent and accessible Treasury market structure would accrue first of all to investors, who would find it easier and cheaper to adjust their portfolios. It is generally accepted, though, that the expected trading costs over the life of a security are impounded (as a discount) in its initial sale price. Market structure enhancements therefore might well lower the cost of financing for US taxpayers.

Sincerely,

[Joel Hasbrouck]

¹ U.S. Securities and Exchange Commission. Regulation NMS, Proposing Release No. 34-49325; February 26, 2004.

² Larry Harris, “Transaction Costs, Trade Throughs, and Riskless Principal Trading in Corporate Bond Markets,” available at SSRN.