Introduction
The Treasury Market Practices Group recognizes the importance of maintaining the integrity and efficiency of the over-the-counter U.S. government securities (Treasury) market. We believe that the public and all market participants benefit from a marketplace that is transparent and efficient. We believe that these characteristics help maintain vigorous competition and liquidity in the Treasury market. Toward that end, we recommend that all Treasury market participants incorporate best practices into their operations in order to promote trading integrity and support an efficient marketplace.

Best practices are meant to serve as guidelines for market participants seeking to organize their operations in a manner that fosters strong controls and reinforces overall market integrity. The best practices in this document are intended not only for dealers but also for any market participant active in the wholesale Treasury market, including brokers, buy-side firms, investors, and custodians. We believe that these best practices, if adopted, can strengthen each market participant’s existing controls. In addition, we believe that the implementation of these best practices will help reduce market disruptions—including but not limited to episodes of protracted settlement failure—and buttress overall market integrity, resulting in important benefits for Treasury market participants and the public alike.

These best practices seek to affirm existing notions of good market conduct and are intended as useful operational guideposts rather than binding rules or regulatory guidance. As each market participant makes use of these recommendations, it should take into account its own unique characteristics, such as asset size, transaction volume, and the form of the organization’s participation in the market (for example, market maker, investor, or custodian).

This compilation is by no means a comprehensive guide to doing business in the Treasury market. Rather, for market participants both new and established in the Treasury market, it can serve as a benchmark when reviewing the adequacy of operating procedures. Of course, in addition to considering these best practices, market participants should ensure that they are following all applicable laws at all times and should avoid illegal activities such as price manipulation.

I. Promoting Market Making and Liquidity
The Treasury market’s smooth and efficient functioning relies on the integrity, honesty, good faith, and mutual trust shown by all participants. An efficient market fosters liquidity, which helps all market participants find buyers and sellers more effectively. It is important for both buyers and sellers to promote market liquidity.
❖ **All market participants should behave in a manner that is consistent with supporting market liquidity.** Dealers, in particular, should promote market making, and all market participants should avoid trading strategies that hinder market clearance. Examples of strategies to avoid include those that cause or exacerbate settlement fails, those that inhibit the provision of liquidity by others, or those that restrict the floating supply of a particular issue in order to generate price movements in that security or related markets.

❖ **Market participants should be responsible in quoting prices and should promote overall price transparency in the inter-dealer brokers’ market.**
- While legitimate price discovery activities are an integral part of the Treasury market and should be encouraged, market participants should avoid pricing practices that do not have an objective of resulting in a transaction.
- Price discovery relies on efficient price reporting and transparent markets. Market participants should not conduct trades through inter-dealer voice brokers with electronic trading screens without having a record of the transaction published on the screen at the time of the transaction.

❖ **Market participants should ensure adequate oversight of their Treasury trading activity.** The nature of oversight may vary depending on the role that each market participant plays in the marketplace and the organizational structure of the firm. However, all firms should develop a mechanism for measuring and scrutinizing the market participant’s overall trading activity in the Treasury market to ensure that trading behavior in the aggregate, as well as along individual business lines, is understood by senior business managers. Oversight coverage should include, at a minimum, the organization’s activities in the Treasury cash markets (including the auction and secondary trading), financing markets (including repurchase agreement transactions), and related derivatives markets.

II. Maintaining a Robust Control Environment to Monitor Questionable Trading Practices
Market participants active in financial markets are familiar with the importance of establishing and maintaining a rigorous internal control environment. Indeed, the variety of legal and reputational pressures to which a market participant’s Treasury trading operations are subject suggests that a vigorous, well-informed, and assertive internal control program is essential. An internal control program should include the active engagement of the business, audit, legal, and compliance functions.

❖ **Each market participant should maintain a strong internal control environment sufficient to ensure that each of its business areas acts in accordance with applicable law and best market practices.** Trading desk management and the supervision, legal, and compliance staff should work collectively to ensure that any questionable trading practices are identified and addressed in a timely manner. Trading desk management and supervision should be aware of, and responsible for, strategies executed by the trading desk. Other control functions, and particularly legal and compliance staff, should be poised to promptly evaluate and respond to questionable trading practices should they occur. Firms should aspire to provide system tools that relay real-time trade position information to the compliance function in order to provide timely notification of large positions.

❖ **Market participants should ensure that the individuals responsible for legal and compliance functions adhere to robust review and oversight procedures regarding trading and settlement operations.** Senior business managers should take responsibility for ensuring that internal control policies are fully implemented and followed in their business areas.

❖ **Individuals responsible for internal control functions should have a sufficient understanding of trading strategies engaged in by trading desks to allow them to recognize potentially problematic activity.** Individuals responsible for internal control functions, and particularly legal and compliance staff, should have sufficient awareness and understanding of the objective and execution of trading strategies to enable them to detect and deter questionable trading that could result in market disruption, illiquid market conditions, or legal or reputational risk to the organization.

❖ **Individuals responsible for internal control functions, and particularly legal and compliance staff, should be empowered to bring any concerns to the attention of appropriate senior business managers within the organization.**

❖ **Internal control policies should identify the specific trading trends, positions, strategies, or behaviors within the trading operation that constitute triggers for mandatory business and compliance review.** Mandatory review does not in itself
automatically suggest that a trading position, strategy, or behavior must be altered; that will depend on the results of the review and consultations between management and compliance. Triggers, among other controls, should aim to identify trading activities that reduce supply circulating in cash or collateral markets. Because the structure of the Treasury market is always evolving, triggers for mandatory review—and the appropriate thresholds for individual triggers—may change over time as the size and structure of the market change. However, market participants should consider including the following non-exhaustive list of indicators in their compliance plan to prompt further review:

- a large concentration of holdings in the floating supply of a particular security (floating supply, at its largest, reflects the amount of the security originally issued less the amount that has been stripped into zero-interest instruments; other factors, such as defeasance programs, can limit floating supply further);
- elevated delivery or receive fails in a particular security and/or the presence of particular trades that persistently fail to settle;
- persistent and deep “specialness” of a security;
- an appreciable or unusual amount of market turnover in a particular security;
- unusual levels or patterns of either profits or losses;
- changes in a market participant’s normal securities lending or borrowing patterns in a security in which a market participant has a large position; and
- when securities are trading “special,” the placement of a substantial percentage of floating supply in general collateral funding arrangements such as GCF or tri-party repo, an apparent increase in such financing over time, or the placement of large blocks of collateral with select counterparties that typically do not recirculate collateral.

III. Managing Large Positions with Care
Although large long or short positions are not necessarily problematic, these positions should be managed responsibly to avoid market disruptions. From time to time, a market participant may amass a particularly large long position in a specific Treasury issue or product. A market participant should manage that position with heightened vigilance, mindful of the need to support market liquidity. Market participants with large short positions or active shorting strategies have similar responsibilities to support the liquidity and smooth functioning of the market.

- Market participants should avoid trading strategies that create or exacerbate settlement fails. Such vigilance should be intensified when a large position predominantly or entirely results from proprietary positioning since the market participant has more control over that position’s size and growth.

- When a participant controls a significant percentage of the floating supply of an issue that is trading deeply special, it should ensure that it is making a good faith attempt to lend the security into the specials market rather than choosing to finance large portions of this collateral in relatively more expensive funding arrangements. Firms should adopt a strong presumption against using relatively more expensive funding arrangements to finance large portions of an issue trading special, even on an overnight basis. If such financing is used, senior management should fully understand why the exception is appropriate. Management and legal and compliance functions should be notified of such activity in a timely manner.

- Market participants with large short positions should make deliveries in good faith. Market participants with a particularly large short position in an issue should ensure that they are making a good faith attempt to borrow needed securities in order to make timely delivery of securities. Market participants should avoid the practice of “strategic fails”—that is, the practice of selling short a security in the repo market at or near zero percent with little expectation of being able to obtain the security to make timely delivery.

- When evaluating trading strategies for large positions, market participants should take care that sudden changes in those strategies do not adversely affect the liquidity or settlement of the issue in the marketplace. Market participants should not refrain from trading when they hold a large position. However, when market participants consider implementing a new trading strategy for a large position, they should evaluate whether it may affect market liquidity. Senior management and legal and compliance functions should be made aware of any significant changes to trading strategies.

- Management and legal and compliance functions should be alerted as soon as possible about particularly large positions—long and short—taken by a trading desk. Market participants should have policies and systems in place to ensure that appropriate personnel in management and in legal and compliance are alerted in time to take actions to safeguard a market participant’s reputation and manage any legal or regulatory risk.
IV. Promoting Efficient Market Clearing
Smooth and predictable settlement and clearing are crucial for preserving the liquidity and efficiency of the Treasury market. Settlement fails prevent the market from clearing efficiently and can damage the market’s liquidity and function. While some settlement fails are inevitable, market participants should take care that their internal policies promote practices that support efficient and timely clearing and that avoid unnecessary market congestion. Market participants should avoid practices that intentionally inhibit the efficient clearing of the market, such as “slamming the wire”—the practice of holding back deliveries until immediately before the close of the securities wire with the intention of causing settlement fails in the market.

❖ A market participant’s policies and systems should ensure that trades are entered promptly into trading systems by the trading desk staff and made available to the operations area as quickly as possible in order to promote efficient settlement.

❖ Market participants should be organized to ensure that the settlement and clearing area is managed independently of the trading desk. Settlement and clearing staff should have reporting lines that are separate from those of the trading staff. In addition, internal controls should be in place to restrict trading staff from delaying or influencing settlement of Treasury securities. Settlement staff should be empowered to question instructions from trading staff by elevating unusual instructions to the attention of management. In addition, policies should require that all requests that deviate from normal settlement practice be communicated to legal and compliance staff in a timely fashion.

❖ A request to “hold the box”—to hold settlement of an executed trade for a period of time—should warrant high scrutiny from trading management, settlement staff, and compliance staff. “Holding the box” is appropriate only in very specific and limited circumstances, such as ensuring a futures contract delivery obligation. “Holding the box” should be appropriately approved by trading management as an exception to the general restriction on traders directing securities settlement. Compliance and supervisory staff should be made aware of such requests in a timely fashion. Repeated or systematic use of “holding the box” for a particular security, absent exceptional circumstances, should not be permissible under a market participant’s operating procedures.

❖ Delivery of Treasury securities should minimize market congestion and the risk of settlement fails. Market participants should have clear policies on how and when to make deliveries of securities in the settlement and clearing process. These policies should include internal “cutoff” times—comfortably in advance of any Fedwire deadlines—by which market participants should provide new trade notifications. For same-day settlement trades entered very late in the trading session, deliveries should be processed as expeditiously as possible.

❖ Incoming securities from counterparties that are to be delivered to other counterparties should be turned around quickly to minimize fails and promote market clearing and settlement. Internal policies and systems should identify a standard turnaround period to ensure that securities are processed in a timely and efficient manner.

❖ All market participants should be diligent in addressing persistent settlement fails. Protracted settlement fails inhibit market function and can reduce market participation. All market participants should aim to resolve persistent fails as soon as possible.