

For release on delivery
2:00 p.m. EDT
October 24, 2016

Opening Remarks on Government Securities Settlement

Jerome H. Powell

Member

Board of Governors of the Federal Reserve System

at

The Evolving Structure of the U.S. Treasury Market: Second Annual Conference

The Federal Reserve Bank of New York

New York, N.Y.

October 24, 2016

This panel will focus on the settlement infrastructure for U.S. government securities -- a vital component of the Treasury market and one that is undergoing an important transition. This segment of the industry has been in a period of slow but steady consolidation for several decades now. Thirty years ago, there were six banks providing a full suite of settlement services for U.S. government securities. Due to mergers and exits, two firms, Bank of New York Mellon (BNYM) and J.P. Morgan Chase (JPMC), have been the two dominant providers of these services since the 1990s. And soon there will be just one, given JPMC's planned exit.

Given the importance of these services, the official sector has had a long involvement as the market structure has evolved. After the terrorist attacks of September 11, 2001, the Federal Reserve convened the private-sector Working Group on Government Securities Clearance and Settlement to recommend steps to mitigate risks to the financial system from a disruption to these services. That work led to the "NewBank" proposal.¹ Although the proposal was ultimately put aside, NewBank would have been a dormant financial institution that could spring into action in the event of potential disruptions from an exit from this business by either of the clearing banks. Some of today's panelists were actively involved in that work. Of course, at that time, the business was roughly evenly split between the two providers. Today's situation is very different – BNYM now has over 80 percent market share, due mainly to consolidation among end users.

The Federal Reserve has been working closely with the Department of the Treasury to ensure a smooth transition as JPMC prepares to exit. JPMC has said that it recognizes the need

¹ Report to the Federal Reserve Board by the Working Group on NewBank Implementation, December 2005. https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwibwreBpOfPAhXM7CYKHfGGAt8QFggeMAA&url=https%3A%2F%2Fwww.federalreserve.gov%2Fboarddocs%2Fpress%2Fother%2F2005%2F20051215%2Fattachment.pdf&usg=AFQjCNGWY_qoYfTbX5xXL7mVn2yV3p2yTA&cad=rja

for, and its own interest in, ensuring that its exit does not disrupt the market. Indeed, JPMC will itself need to rely on these services going forward. The timeline set for a gradual transition over the next two years should be sufficient to avoid significant dislocations; however, if unexpected complications arise, that timeline may need to be adjusted.

In the near term, this exit will leave BNYM as the sole provider of U.S. government securities settlement and triparty repo services for broker-dealers. We have been working intensively with BNYM in anticipation of this transition. We have long recognized that any disruptions to these critical market services could have serious consequences for financial stability, and have calibrated our supervisory expectations accordingly. To ensure financial stability, we expect the provision of U.S. government securities settlement services to be robust in nearly all contingencies.

As BNYM becomes the sole provider, we will raise our expectations even higher. The bank has anticipated and welcomed this higher bar. BNYM is one of 8 U.S.-based systemically important banks. The bank is therefore subject to heightened capital and liquidity requirements and a resolution process that explicitly requires planning to ensure the continuity of critical services even in the event of a default.

BNYM is unique in that it also plays the dominant – and soon the sole – role in government securities settlement and in the triparty repo market. These activities are comparable in their importance to those of the financial market utilities that have been designated as systemically important by the FSOC. Thus, BNYM will continue to be held to the high standards to which all U.S. bank SIFIs are held. And it will also be expected to operate in a manner that provides confidence that it is as resilient and robust as a systemically important financial market utility (FMU). Such FMUs are, of course, held to the Principles for Financial

Market Infrastructures (PFMIs).² The PFMIs overlap with our banking regulation in many areas; for example, both emphasize the need for sound risk management and the importance of resilience and recovery. The PFMIs also emphasize a strong governance role in support of financial stability and the interests of market functioning, and this has been a focus of our work with Bank of New York Mellon regarding the transition.

Although our current task is to establish appropriate expectations for Bank of New York Mellon as a sole operator, that focus should not be taken as an indication that the Federal Reserve or other public authorities have pre-judged what the longer-term landscape for government securities settlement should look like. In fact, we do not have a specific market design end state in mind. Rather, we recognize the systemic importance of these activities and the need to ensure their continued availability in nearly all states of the world, regardless of the firms that offer them or the specific market structure.

The industry as a whole should play an important role in shaping the evolution of the settlement infrastructure. Other firms may seek to enter this market. There have also been discussions over time of a settlement utility, and the Depository Trust & Clearing Corporation is currently considering a new variant of such a model. Our focus is on the quality of the services offered -- their safety, resilience, and support of the market -- and not on the particular mechanism for offering them. If new proposals come forward that are consistent with our goals of a safe and resilient settlement system, then they will receive fair consideration.

² See Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (2012), *Principles for Financial Market Infrastructures*, report (Basel, Switzerland: Bank for International Settlements, April), www.bis.org/publ/cpss101.htm