Discussion of "Treasury Inconvenience Yields during the COVID-19 Crisis" by He, Nagel and Song

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Overview

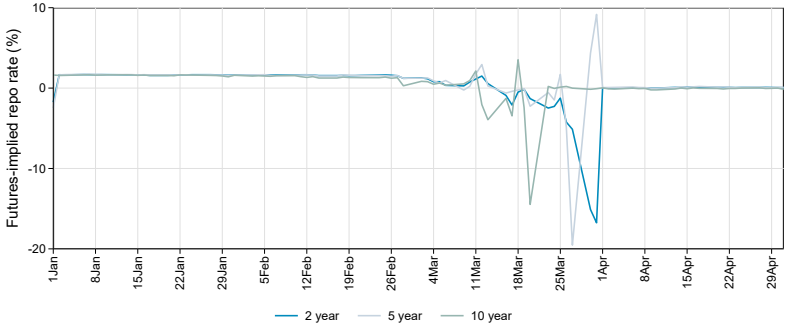
- Post-crisis regulatory changes increased recognition of repo/reverse repo positions for BHC regulatory leverage

$\Rightarrow$ Changes BHC willingness to take on leverage and provide leverage to clients

$\Rightarrow$ Repo-funded positions more balance-sheet expensive

$\Rightarrow$ Require more compensation for absorbing flows of repo-funded securities

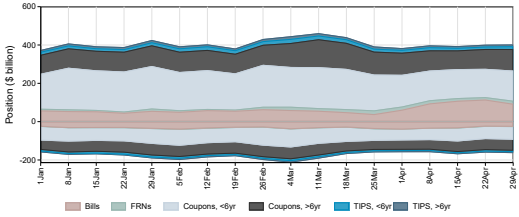
Treasury market dislocation in March



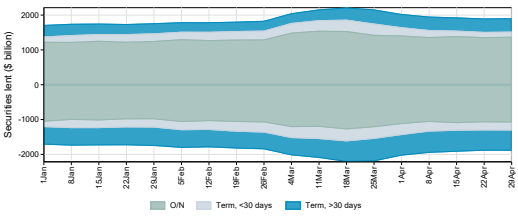
- Bigger dislocations early on in longer maturities...

Lead to bigger increases in Treasury positions for dealers in longer term securities

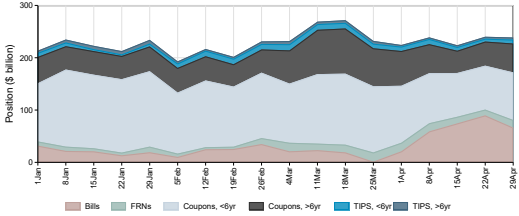
(a) Signed positions



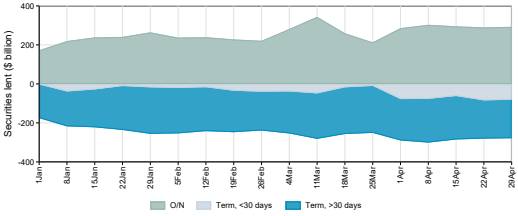
(b) Signed financing



(c) Net positions



(d) Net financing



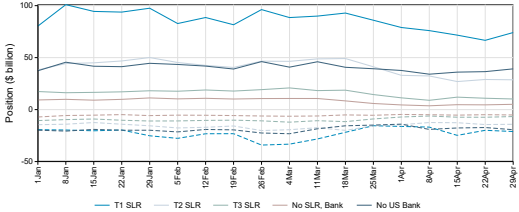
Approach

- Group dealers into categories based on BHC-level SLR as of Q4 2019
  - Dealers with a U.S. bank, subject to SLR: into terciles (T1=low reported SLR, most constrained)
  - With a U.S. bank, not subject to SLR
  - No U.S. bank
- Focus specifically on:
  - Positions in long ($>$ 6yr) vs short maturity coupon bonds
  - O/N vs term securities financing

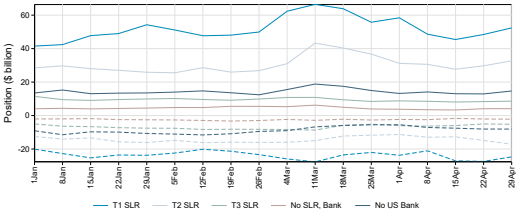
Hypothesis: March Treasury market dislocations because constrained dealers had to absorb stressed customer flow

More constrained dealers absorbed more longer term securities

(a) <6 year



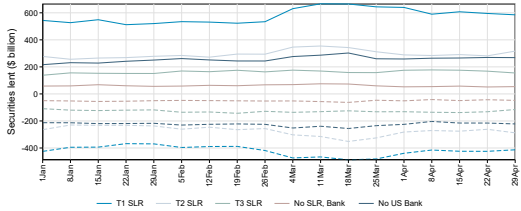
(b) >6 year



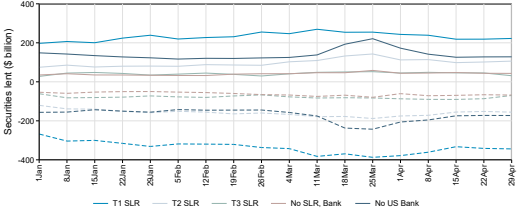
- Lower SLR (more constrained) $\Rightarrow$ bigger increases in positions in coupons $>$ 6 year maturity
  - Also in percentage terms relative to Jan 1, 2020 positions
- Increases in both long and short positions in coupons $>$ 6 year maturity
- Increases in short positions in coupons $<$ 6 year maturity
- Dealers without a U.S. BHC act like "medium" SLR dealers

Financed in overnight repo

(a) Overnight



(b) Term



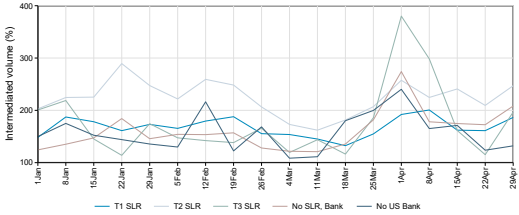
- Lower SLR (more constrained) $\Rightarrow$ bigger increases in positions financed through overnight repo
  - Also in percentage terms relative to Jan 1, 2020 financing levels
  - Both in terms of actual repo and net relative to reverse repo

  $\Rightarrow$ Dealers expected dislocations to be short-lived?

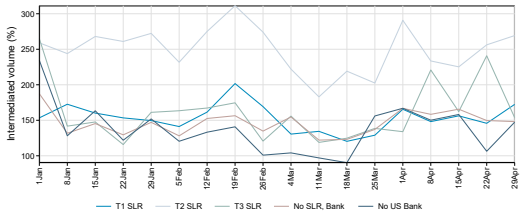
  $\Rightarrow$ Or reluctant to use term repo because of LCR considerations?
- Increases in term reverse repo positions by lowest SLR dealers and dealers without U.S. banks

Customer flow particularly disruptive in longer term securities

(a) <6 year



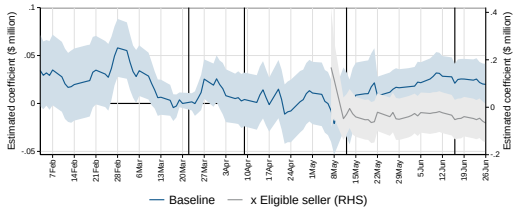
(b) >6 year



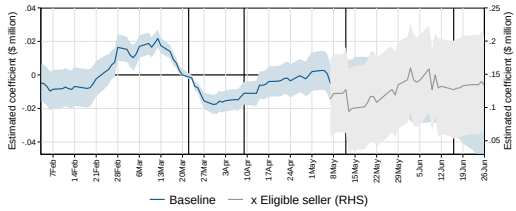
- Intermediated volume: ratio between transactions with "others" and transactions with "interdealer brokers"
  - Low intermediated volume $\Rightarrow$ more interdealer trading to find ultimate customer
- Similar decreases in intermediated volume across SLR categories $\Rightarrow$ all dealers found client volume problematic to absorb

Regulatory constraints seem not to be a key driver in corporate market dislocations

(a) Below 5 year, bank-affiliated



(b) Below 5 year, other



Dealers not affiliated with U.S. banks:

- Decrease longer-maturity inventory differentially more
- And decrease inventory in high yield bonds

$\Rightarrow$ Suggests smaller role of regulatory constraints for dislocations in corporate bond markets

Source: Boyarchenko, Kovner and Shachar (2020)

Summary

- Micro FR 2004 data consistent with the basic hypothesis:
  - Large volume of customer flows absorbed by most SLR-constrained dealers
  - Such dealers had to be compensated for the increased capital requirement through lower Treasury prices
  - I.e. higher breakeven basis as in Boyarchenko, Eisenbach, Gupta, Shachar and Van Tassel (2018)
- But regulatory constraints seems to have played a smaller role in other markets
  - Despite large fire sales by bond mutual funds

What is it about the Treasury market in particular that played out different in March?

Smaller comments

- Positions/repo funding nettable only if with the same counterparty, same terms
  $\Rightarrow$ gross position, not net position, matters for regulatory constraints
- Is GCF-TPR the right measure of repo intermediation spread?
  - TPR: rate at which dealers borrow from MMMF
  - GCF: rate at which dealers lend to other dealers
- SLR literature assumes SLR binding starting in 2014, not 2015 as in the current paper