TESTIMONY OF
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BEFORE THE
U.S. House of Representatives Committee on Financial Services
Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity
Examining Derivatives' Role in the Treasury Market
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Chairman Lucas, Ranking Member Vargas, and Members of the Committee, I am Terry Duffy, Chairman and CEO of CME Group Inc. ("CME").[1] Thank you for the opportunity to testify today regarding the importance of the derivatives markets to the function and stability of U.S. Treasuries.

Futures on Treasuries were first offered in 1977. They allow market participants to hedge long-term risk and interest rate exposure. They have also afforded a major benefit to U.S. debt financing by providing price discovery, enhanced liquidity, reduced borrowing costs for the Treasury, and increased efficiency.

CME Group services the entire Treasury market ecosystem; including trading and clearing for the Treasury and interest rate derivatives for futures, options, and swaps; but also offering trading in cash Treasury markets, and soon to be launched this year, clearing services for cash Treasury markets. In addition, CME partners with the Fixed Income Clearing Corporation (FICC) in order to service the entire Treasuries value chain, which provides efficiencies for the entire global customer base of Treasury securities.

My testimony today focuses on three critical pillars:

- the vital role of derivatives,
- updates to the clearing landscape, and
- the positive implications of the Basel III Endgame re-proposal.

I. Treasury Market Functionality - Derivative Markets Benefits

Derivatives Markets Support Liquidity and Price Discovery in the U.S. Treasury Markets

Derivatives are foundational to the price discovery, liquidity, and functionality of the U.S. Treasury markets. Highly liquid Treasury futures allow market participants to secure risk management hedges in customizable sizes without having to source the individual Treasury securities.

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[1] CME Group Inc. ("CME Group") is the parent of the Chicago Mercantile Exchange Inc. ("CME"). CME is registered with the Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO") and is one of the largest central counterparty ("CCP") clearing services in the world. CME's clearing house division offers clearing and settlement services for exchange-traded futures and options on futures contracts, as well as over-the-counter ("OTC") derivatives transactions, including interest rate swaps ("IRS") products. On July 18, 2012, the Financial Stability Oversight Council designated CME as a systemically important financial market utility under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") based on its U.S. exposures, among other things. *See* Minutes of the Financial Stability Oversight Council, pg. 5 (July 18, 2012), *available at* https://www.treasury.gov/initiatives/fsoc/Documents/July%2018%20FSOC%20Meeting%20Minutes.pdf.

As observed by the Treasury Borrowing Advisory Committee (TBAC), "Open interest [in Treasury futures] has grown with the overall size of the Treasury market."[2] Treasury futures volume in notional terms closely follows volumes in cash Treasuries, with futures volume representing ~93% of cash volume during the previous year.

There are two important links between the cash and futures markets: 1) The use of Treasury futures by market makers, including primary dealers, to hedge their Treasury inventory; and 2) The use of Treasury futures by asset managers to add duration to their portfolios and the intermediation of this activity by leveraged funds through the Treasury basis trade.

Treasury futures contracts are generally more liquid than Treasury cash securities. These contracts facilitate individual transactions that can be satisfied by a range of Treasury securities with different maturities and coupons, thereby helping to foster liquidity by centralizing trading activity. In contrast, Treasury securities trading activity may happen in various trading venues, including over-the-counter markets. Additionally, cash Treasury markets feature hundreds of different Treasury securities with various maturities and coupon amounts, which are not interchangeable.

As explained by the Federal Reserve Bank of Chicago in Chicago Fed Letter, No. 516, "Overall, the interconnectedness of Treasury futures and cash security markets creates a positive feedback loop, as enhanced liquidity in the derivatives market strengthens the functioning of the cash market (and vice versa). Moreover, the enhanced liquidity supports more-stable, lower-cost public financing."[3]

In addition to providing enhanced liquidity, Treasury futures are vital points of price discovery for the Treasury market – both during Treasury primary issuance and during secondary market trading. By providing a highly liquid and transparent, on-going, auction system, Treasury futures provide a forum for markets to quickly price in new and emerging information, assess the risk participants are seeking to hedge, evaluate market predictions, and achieve a clearer understanding of the future price of Treasury securities. The cash-futures basis trade serves as a link that brings market efficiency and forces prices to converge at settlement.

Hedging Price Risk and Interest Rate Exposure

Treasury futures are a critical source of price discovery for the Treasury market – both during Treasury primary issuance and during secondary market trading. Given the link between cash and futures prices, market makers in cash Treasuries use futures to hedge their inventory. For example, a Federal Reserve Bank of New York Staff Report found that primary dealers partially hedge their inventory using Treasury futures.[4]

Treasury futures can be settled via deliverable Treasury securities which meet the maturity tenor of the individual contracts. This process helps facilitate liquidity aggregation across the broad list of available Treasury securities and allows market participants to obtain risk management hedges in customizable sizes without having to source the individual Treasury securities.

Furthermore, Treasury futures markets are efficiently linked to the securities markets via the

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[2] https://home.treasury.gov/system/files/221/TBACCharge1Q12024.pdf

[3] ttps://www.chicagofed.org/publications/chicago-fed-letter/2026/516#:~:text=Overall%2C%20the%20interconnectedness%20of%20Treasury,%2C%20lower%2Dcost%20public%20financing

[4] https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr299.pdf

Treasury basis markets. CFTC data shows that asset managers tend to hold significant net long positions in Treasury futures. Asset managers may prefer Treasury futures over cash Treasuries as a way to add duration to their portfolios due to leverage and efficiency benefits. Asset manager demand for Treasury futures is intermediated by leveraged funds that engage in basis trading between cash and futures markets, as further discussed below.[5]

Estimates from the Federal Reserve indicate that basis trade-related holdings of Treasury securities by leveraged funds have increased by $317 billion since the first quarter of 2022, with some estimates that leveraged funds hold $1 trillion in notional value of Treasury Futures.[6]

These links demonstrate the importance of the Treasury futures market for both market makers in the Treasury market and natural holders of Treasury securities (asset manager accounts via leveraged funds).

As discussed further in the next section, CME has been making significant investments to increase the efficiency of these markets both with its important partner, the FICC, and through its own independent Treasury clearing initiatives. Together, CME's derivatives markets and basis markets help provide efficiency in hedging Treasury markets, which ultimately help the U.S. Government to fund itself in a highly efficient manner benefiting everyone from Main Street to Wall Street.

The liquidity, transparency, and reliability of Treasury futures markets enable a more efficient Treasury market, which in turn lowers the cost for the government to finance its expenditures, and is crucial to U.S. financial stability.

II. Treasury Clearing

CME's derivatives central clearing services provide the critical infrastructure that underpins a more efficient and resilient Treasury market, providing risk management benefits to a diverse set of market participants. These services offer the ability for participants to transact and clear in highly efficient, transparent, and regulated markets.

CME provides clearing services across a diverse set of derivative asset classes, including interest rates, equities, FX, energy, agricultural products, and beyond. Clearing this expansive set of asset classes allows for efficient portfolio risk management benefits and offsets for diverse portfolios. These portfolio benefits allow market participants to manage their risks in efficient methods, which reflect the risk-offsetting nature of their products.

CME recognizes that portfolio efficiencies are necessary to help participants efficiently use the variety of risk management tools available to them. Currently, these benefits create approximately $82 billion in total daily savings, and importantly are available to anyone in our markets, from America's farmers and ranchers, to firms on Wall Street, to mortgage providers. These savings are passed on to consumers in the form of stable prices at the grocery store, lower fees on retirement accounts, and lower costs for first time home buyers.

[5] https://home.treasury.gov/system/files/221/TBACCharge1Q12024.pdf

[6] https://www.federalreserve.gov/econres/notes/feds-notes/quantifying-treasury-cash-futures-basis-trades-20240308.html

A key example of those portfolio efficiencies is found in CME's cross-margin program with the FICC, where CME provides "Cross-Product" netting benefits, which are essentially ways for participants to recognize the risk-offsetting nature of derivatives and U.S. Treasury cash instruments. Since enhancing this program in partnership with the FICC in January 2024, CME now has over 20 participants that have executed the necessary legal agreements to participate. Through this partnership, CME is able to routinely save firms over $1 billion in their margin requirements every day, which allows them to redeploy that capital into Treasury markets and provide the liquidity necessary for price discovery.

CME is excited to be expanding upon this program with the FICC to provide access to cross-margining for end-user clients within the U.S. Treasury markets, which the CFTC and SEC recently approved, to help them manage their requirements as they transition to central clearing.

Finally, the SEC's new clearing mandate, which requires central clearing for certain U.S. Treasury securities, will transform the Treasury marketplace and bring additional new participants into central clearing. These new participants will add to the liquidity and efficiency that is already being achieved through central clearing.

CME plans to expand its own central clearing services, which will provide a securities clearing solution specifically for U.S. Treasury securities. Building on 100+ years of experience clearing a variety of financial instruments, CME will bring operational excellence to the Cash Treasury and Repo markets. While CME remains a committed partner with the FICC, we believe that as markets evolve in response to the SEC's central clearing requirements, market participants will benefit from choices and options to help them find the most efficient solutions for their risk management needs. CME intends to launch our Treasury clearing service in Q3 of 2026. At that time, CME securities clearing will provide the ability to cross-margin with CME's derivatives products, continuing the extension of CME's capital efficient solutions for market participants.

CME's Cash Treasury and Repo clearing service will support both "done with" clearing (in which a single broker executes both the trade and the clearing service) and "done away" clearing (in which one broker executes the trade but clears through a designated agent), providing greater choice for clients and Members in managing their relationships. Additionally, clearing Treasury securities directly will allow CME to expand upon the $25 billion in daily interest rate margin savings already being delivered across interest rate cash, repo, futures, options, and swap products. Cross-margining between swaps, options, futures, and cash cleared products within CME's clearing ecosystem will provide a unique and unparalleled opportunity for managing interest rate risks with maximum risk-sensitive efficiencies.

III. Basel III Endgame 2026 Re-Proposal

Ensuring that capital can be allocated efficiently and appropriately based on risks in the financial system has always been a core tenet of CME Group's financial policy positions. This was brought more sharply into focus shortly after the financial crisis, when CME worked closely with bank regulators and market participants to ensure that newly developed bank capital regulations related to cleared derivatives appropriately recognized the risk management benefits and protections inherent to central clearing. The Basel III Endgame reproposal issued in March 2026 by the US Banking Regulators furthers this policy goal in the following ways:

Cross-Product Netting

As I mentioned earlier, CME provides margin efficiency and risk management benefits across derivatives and cash products in a way that is acceptable to our market regulators, the CFTC and SEC. A vital piece of the Basel III Endgame re-proposal would allow banks to realize these margin and risk management benefits by appropriately reflecting the true risk of exposures in bank capital requirements.

Listed Options Products

Additionally, risk-reducing hedging through listed options is properly understood by the re-proposal as being risk-offsetting and is appropriately reflected in the re-proposal's capital standards.

Recognizing the Benefits of Central Clearing

Other changes that appropriately reflect the risk-reducing benefits of central clearing include elimination of client credit valuation adjustment (CVA) charges, which are unnecessary in central clearing, and removal of central clearing exposures from the Global Systemically Important Banks (GSIB) calculations for large banks, which otherwise discourage risk management through central clearing due to increased capital costs. Adjusting calculations to remove those disincentives promotes the use of central clearing, which the Basel Committee has prioritized as a key tenet of stability since the 2008 financial crisis.

<u>IV. Foreign Clearing of U.S. Sovereign Debt</u>

The U.S. Treasury market is critical to our nation's economy and economic stability. I am very concerned about allowing a foreign central counterparty clearing house (CCP), regardless of whether that CCP is dually registered with a foreign regulator and the CFTC, to administer a market function over any portion of U.S. debt. This opens the door to a foreign regulator exercising authority and control over one of the most critical functions of the U.S. government and economy. Allowing a portion of the U.S. Treasury market to be controlled by a foreign jurisdiction sets a dangerous precedent and exposes the long-term stability of U.S. debt to uncertainty.

FMX, a U.S. exchange, self-certified last year with the CFTC to trade U.S. Treasury futures cleared by a London-based clearing house that is regulated and supervised by the U.K.'s Bank of England. While the clearing house is also registered with the CFTC, its dual registration with the U.S. and U.K. does not impact the fact that its ultimate guarantor is the Bank of England. As guarantor, the Bank of England has the legal right, should it choose to exercise it, to upend the free flow and trade of U.S. Treasuries that are processed by a clearing house under its jurisdiction.

In fact, under U.K. law, the Bank of England's primary mandate is to maintain the stability of the British financial system, not the U.S. system. In the event of a systemic crisis, like a massive liquidity crunch in both Gilts and/or U.S. Treasuries, the Bank of England is legally obligated to prioritize the Gilt market and the British pound over all other markets, including the U.S. Treasury market.

If a U.K.-based clearinghouse faced a capital shortfall, the Bank of England could use its early resolution authority to intervene and haircut or tear up U.S. Treasury contracts. This could trigger a default chain in the U.S., spiking borrowing costs for the U.S. government and destabilizing the U.S. Treasury market.

Allowing the U.K. government to have this regulatory power over such a critical component of the U.S. Treasury market is a significant risk. Members of this Task Force should insist that U.S. futures be treated the same as cash Treasuries – which can only be overseen by a U.S. regulator.