Negative Treasury Haircuts

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Discussion:
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What the paper shows

(1) Dealer banks lend to cash borrowers at **negative** Treasury repo haircuts
   - average bilateral RRP haircut: -19 bps; negative on 66% of days

(2) Cash lenders to dealers demand **positive** haircuts
   - tri-party repo haircuts are around $+1.27\%$

(3) Haircuts vary across **time** and **dealer banks**
   - time FE explain 18%; bank FE explain 21%; counterparty FE explain 2%

(4) Dealer warehousing capacity matters
   - one s.d. higher net collateral position $\Rightarrow$ about 18 bps lower haircuts

Negative haircuts have two economic readings

- **Initial leverage provision**
  - dealer lends more cash than the market value of collateral
  - secured Treasury repo is bundled with unsecured credit
- **Stable term funding**
  - cash loan stays fixed while Treasury collateral value moves
  - if the dealer does not call margin, the haircut absorbs the shock
- Either way, the haircut allocates collateral-value risk:

Dealer absorbs shock	Borrower absorbs shock
haircut becomes more negative	margin top-up or funding cut
stable bilateral term funding	cleared or tightly margined funding

Comment 1: A new measure of dealer risk-bearing?

- The first-order contribution is **measurement**
  - daily, dealer-level, market-close effective Treasury repo haircuts
  - by dealer, counterparty type, settlement type, and tenor
- Interpret this as a price-based measure of **dealer risk-bearing in Treasury secured funding markets**
- Natural benchmark: intermediary asset pricing
  - dealer leverage / capital ratios / SLR pressure
  - Treasury basis, liquidity, swap spreads, CIP deviations
  - HKM intermediary capital factor (He et al., 2017)

Question: After removing the mechanical duration component, does the residual haircut behave like an intermediary-constraint measure?

Comment 2: What exactly makes haircuts negative?

	Initial leverage provision	Stable term funding
Economic object	unsecured credit bundled into repo	insurance against margin calls
Inception haircut	already negative	near zero / positive
How it turns negative	dealer chooses to over-lend	collateral value falls and funding is kept fixed
Key mechanism	regulatory arbitrage, monitoring, warehousing	term repo, duration risk, no margin top-up
Direct test	negative at trade start	becomes negative after mark-to-market

Request: Decompose each negative haircut into an inception component and an ex post collateral-return component.

Comment 2: The tenor pattern is the strongest current evidence

- If stable term funding is important, negative haircuts should get stronger with repo tenor
- The appendix already shows exactly this pattern

Repo tenor	RRP	Repo	RRP haircut	Repo haircut
Day	481	491	0.001	0.466
Week	215	204	-0.174	0.317
Month	175	114	-0.252	-0.134
Quarter	135	84	-0.446	-0.014
Quarter+	46	35	-0.503	-0.352

Request: Promote the tenor table from the appendix and estimate the pass-through coefficient by repo tenor.

Comment 3: Stable funding is not automatically fragility

- If dealers provide stable term funding, borrowers avoid immediate margin calls
- That can stabilize the market in the short run
- Fragility comes only if stable funding creates:
  - larger positions ex ante
  - hidden dealer tail exposure
  - delayed but larger margin calls
  - sudden funding cuts when dealer capacity binds

Question: Does negative-haircut exposure predict future margin calls, funding cuts, dealer pullback, or Treasury sales?

Comment 3: Quantify the deferred margin call

- Hold the initial haircut fixed
  - or use zero haircut / CCP-style margining as benchmarks
- Let Treasury collateral values move
- Compute the collateral top-up or cash repayment needed to keep the haircut stable
- Aggregate by borrower, dealer, day, repo tenor, and collateral duration
- Compare with stress periods, basis-trade unwinds, repo-rate stress, and dealer pullback

Question: Are deferred margin calls large and concentrated enough to matter for Treasury-market fragility?

Conclusion: "Negative Treasury Haircuts"

(1) The paper's data contribution is large: daily dealer-level market-close effective Treasury repo haircuts

(2) The safer interpretation is a measure of dealer risk-bearing, not only a measure of initial leverage

(3) The key empirical split is inception leverage vs. ex post mark-to-market exposure

(4) The tenor pattern is the strongest current evidence; the clean test is transaction-level decomposition

(5) The paper matters most if hidden dealer risk later reappears as margin calls, funding cuts, or dealer constraints

Important paper. New measurement.
Sharper risk-allocation tests will make the contribution much clearer.

References I

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Appendix

Backup: Where is dealer compensation?

If dealers provide...	Dealer cost	Where compensation may appear
Extra initial leverage	unsecured counterparty credit	higher repo spread; client-level credit pricing
Stable term funding	margin-call insurance; collateral-value risk	higher term spread or concessions on related trades
Balance-sheet capacity	scarce SLR / liquidity / internal funding	relationship rents; prime brokerage revenues; regulatory treatment

- If dealers provide funding insurance, where is compensation?
- Repo spreads, term premia, relationship rents, prime brokerage, or regulatory treatment?

Backup: Trade-time and market-close haircuts can both be right

- Related trade-time evidence often shows zero or very low repo haircuts (Hempel et al., 2023; Hermes et al., 2025)
- BLW's data are market-close and mark Treasury collateral to market
- A trade can start near zero and end the day with negative effective exposure
- Daily changes:
  - $\Delta H_t = \alpha + \beta \Delta y_t + \epsilon_t$
  - slope ≈ -3.5; $R^2 \approx 67\%$ on daily changes
- Levels:
  - yield changes explain only 11% of haircut levels
  - persistent negative levels are not just daily yield drift

Backup: Direct tests with transaction-level data

Test	Initial leverage story	Stable-funding story
Haircut at trade inception	negative already	near zero or positive
Role of repo tenor	not necessarily monotone	more negative as tenor lengthens
Role of collateral duration	secondary	high-duration collateral should move haircuts more
Margin calls / top-ups	not central	limited top-ups; haircut absorbs price moves
Bilateral vs. centrally cleared	bilateral can take counterparty credit risk	shocks more likely to show up through borrower margin / funding adjustment

Crucial statistic: what share of negative end-of-day haircuts were already negative at inception?

Backup: Asset-pricing extension

- Intermediary asset pricing predicts dealer balance-sheet capacity should price broader assets (He and Krishnamurthy, 2013; Adrian et al., 2014)
- Use residual haircuts after removing the mechanical duration component
- Test whether aggregate haircuts comove with / forecast:
  - Treasury cash–futures basis
  - Treasury noise / illiquidity (Hu et al., 2013)
  - HKM intermediary capital factor (He et al., 2017)
  - hedge fund deleveraging events (Kashyap et al., 2025)