

## DEPARTMENT OF THE TREASURY

## Fiscal Service

## 31 CFR Part 356

[Docket No. BPD-2012-0002]

## Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds

**AGENCY:** Office of the Assistant Secretary for Financial Markets; Fiscal Service, Treasury.

**ACTION:** Advance Notice of Proposed Rulemaking.

**SUMMARY:** The Department of the Treasury (“Treasury”) intends to issue a new type of marketable security with a floating rate interest payment. We are issuing this Advance Notice of Proposed Rulemaking to solicit comments on the design details, terms and conditions, and other features of this new type of security. We also invite other comments relevant to the issuance of this new security.

**DATES:** Submit comments on or before January 22, 2013.

**ADDRESSES:** Comments may be submitted electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>, in accordance with the instructions. Comments will be available at <http://www.regulations.gov> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. You may download this notice from <http://www.regulations.gov> or the Bureau of the Public Debt’s Web site at <http://www.treasurydirect.gov>. Questions about submitting comments should be directed to Lori Santamarena at (202) 504-3632. You may also send paper comments to Bureau of the Public Debt, Government Securities Regulations Staff, 799 9th Street NW., Washington, DC 20239-0001. Comments received will be available for public inspection and copying at the Treasury Department Library, Main Treasury Building, 1500 Pennsylvania Avenue NW., Washington, DC 20220. To visit the library, call (202) 622-0990 for an appointment. In general, comments received, including attachments and other supporting materials, are part of the public record and are available to the public. Do not submit any information in your comments or supporting materials that you consider confidential or inappropriate for public disclosure.

**FOR FURTHER INFORMATION CONTACT:** Colin Kim, Director, Office of Debt Management, Office of the Assistant

Secretary for Financial Markets, at [debt.management@treasury.gov](mailto:debt.management@treasury.gov).

**SUPPLEMENTARY INFORMATION:** The Secretary of the Treasury is authorized under chapter 31 of title 31, United States Code, to issue United States obligations and to offer them for sale under such terms and conditions as the Secretary may prescribe. The Uniform Offering Circular, in conjunction with the announcement for each auction, provides the terms and conditions for the sale and issuance of marketable Treasury bills, notes, and bonds in an auction to the public.<sup>1</sup>

Treasury intends to issue a new type of marketable security with a floating rate interest payment. We are currently considering two *Index Rates*<sup>2</sup> for this purpose, a Treasury bill rate and a Treasury general collateral repurchase agreement rate. Through this notice, we are soliciting comments on the design details of the planned floating rate security and which index (those mentioned above or another index) should result in Treasury attaining the lowest borrowing cost over time for government financing needs. At the end of this notice is a hypothetical term sheet (Appendix A) and a link to proposed formulas (Appendix B) applicable to the structure being considered.

This Advance Notice of Proposed Rulemaking is not an offering of securities and any of the currently contemplated features of floating rate securities described in this notice may change. The terms and conditions of particular securities that Treasury may offer will be provided in the Uniform Offering Circular and the applicable offering announcement.

Treasury intends to issue floating rate securities to assist us in our mission of borrowing at the lowest cost over time, as well as to manage the maturity profile of our marketable debt outstanding, expand the investor base, and provide a financing tool that gives debt managers additional flexibility. We plan to integrate floating rate securities into our ongoing efforts to extend the maturity profile of our marketable debt. We decided to establish a floating rate securities program after carefully considering the long-term supply and demand dynamics for floating rate securities and with significant consultation with market participants.<sup>3</sup>

<sup>1</sup> The Uniform Offering Circular is codified at 31 CFR part 356.

<sup>2</sup> All capitalized, italicized words are defined in the Appendices.

<sup>3</sup> In its February and May 2012 Quarterly Refunding Statements, Treasury requested input on the potential issuance of floating rate securities. In

We issued a Notice and Request for Information<sup>4</sup> on March 19, 2012, to solicit market input on a possible floating rate security, particularly concerning the demand for the product, how the security should be structured, its liquidity, the most appropriate index, and any operational issues that should be considered relating to the issuance of this type of debt. Based on the responses to that notice, Treasury announced in its August 2012 Quarterly Refunding Statement that it plans to develop a floating rate securities program to complement the existing suite of securities it issues and to support our broader debt management objectives. The first floating rate securities auction is estimated to be at least one year away. This timeframe reflects our best estimate for implementing required auction regulations and computer systems modifications.

*Index Rate:* No consensus exists among market participants on the ideal index for Treasury’s floating rate securities program. Many believe, however, that the *Index Rate* should reference a liquid, traded rate with transparent pricing.

We are requesting comments on which *Index Rate* should result in Treasury attaining the lowest cost of financing over time. Specifically, we are considering (1) the 13-week Treasury bill auction High Rate (stop out rate) converted into a simple ACT/360 interest rate<sup>5</sup> (the “*Treasury Bill Yield*”) and (2) a Treasury general collateral overnight repurchase agreement rate (the “*Treasury GC Rate*”). We also request comments on whether another index would better serve the desired purpose.

If Treasury’s floating rate securities program were to be indexed to the *Treasury Bill Yield*, it would reference the converted auction stop out rate of 13-week Treasury bills, currently auctioned weekly. Under the current auction schedule, the *Index Rate* would change weekly, on Thursday, which is the settlement day for 13-week Treasury bills (non-Business Days excepted). Treasury requests comments on whether the conversion of the High Rate should be done on an ACT/360, ACT/365 or

addition, Treasury has discussed the topic with the Treasury Borrowing Advisory Committee, which is a federal advisory committee sponsored by the Securities Industry and Financial Markets Association, and with the primary dealers. The primary dealers serve as trading counterparties of the Federal Reserve Bank of New York in its implementation of monetary policy. Primary dealers are also required to participate in all Treasury marketable securities auctions.

<sup>4</sup> 77 FR 16116 (March 19, 2012).

<sup>5</sup> An example of this conversion is provided in Appendix B.

some other basis. Treasury would also appreciate comments on whether the *Treasury Bill Yield* should reference a Treasury bill maturity other than the 13-week bill.

The other *Index Rate* we are considering for our floating rate securities program is a Treasury General Collateral (GC) Rate. Currently, approximately \$650 billion<sup>6</sup> of Treasury securities are used as collateral in tri-party overnight loans each day. Money is lent to borrowers, collateralized by Treasury securities, at the overnight *Treasury GC Rate*. This rate represents transactions in a highly liquid market. While a *Treasury GC Rate* representing all tri-party repurchase agreement (repo) transactions currently is not published, the Depository Trust & Clearing Corporation (DTCC) publishes the Treasury General Collateral Finance (GCF) rate,<sup>7</sup> which represents a subset of tri-party Treasury GC repo transactions. Please comment on the relative merits of using a broader tri-party Treasury GC rate as compared to a narrower subset, such as DTCC's Treasury GCF index, as the *Index Rate*. Please note that we are not considering the use of an index that represents tri-party repo transactions in any collateral other than Treasury securities.

**Reset Frequency:** With either *Index Rate*, we would structure the floating rate security with daily resets. If we were to select a rate indexed to the 13-week Treasury bill, the rate would reset daily but, given the current auction schedule, the rate would actually change no more than once a week, generally on Thursday. We would want to allow the *Index Rate* to reset daily to maintain flexibility in our future auction schedule.

If we were to select a *Treasury GC Rate* as the *Index Rate*, the daily *Reset Frequency* would have a *Determination Date* of one *Business Day* prior. Given that most Treasury securities trade in the secondary market for settlement the next *Business Day*, referencing the previous *Business Day* would allow the accrued interest to be known at the time of the trade versus only on the settlement date.

Regardless of choice of index, any forward trades settling beyond one business day could have unknown accrued interest. Please comment on

whether this would present problems for market participants.

**Frequency of Interest Payments:** Treasury would make *Interest* payments on its floating rate securities quarterly. This payment cycle is a departure from our semi-annual payment cycle. Most existing floating rate securities pay a quarterly interest payment and, given the non-compounding interest calculation currently being considered, a quarterly paying security seems to be the preferred structure. We welcome comments on a quarterly versus semi-annual, or other, payment structure.

**Lock Out Periods:** The current convention in the floating rate securities market is for interest payments to be set five business days in advance of the *Payment Dates*. This standard practice dates back to the late 1980s. Investors requested the five business-day notice for operational purposes. Given technological advancements, we believe one *Business Day* notice of interest payments should suffice. Please comment on the appropriate length of the lock out period.

**Interest Rate:** The *Interest Rate* on the floating rate securities would be the *Index Rate* plus the *Spread*.

**Minimum Interest Rate:** The floating rate securities would have a *Minimum Interest Rate* of zero. A negative *Interest Rate* could lead to an interest payment by the investor to Treasury, which could have operational and tax consequences. This *Minimum Interest Rate* feature could increase the value of these securities in certain interest rate environments. We could capture this value at auction by allowing floating rate securities to be issued at a premium.<sup>8,9</sup>

We would like commenters to address the potential need for a *Minimum Interest Rate* of zero percent (or some other level). Treasury would also appreciate comments on whether there is an alternative to the *Minimum Interest Rate* structure that would be preferable.

**Minimum Spread:** Treasury would set a *Minimum Spread* of zero on the floating rate securities to ensure that they are issued at a premium in certain interest rate environments. We would like comments on whether some other level is the appropriate *Minimum Spread*.

**Interest Accrual:** Interest will accrue on floating rate securities at the *Interest Rate*, with a daily *Reset Frequency*, during the *Accrual Period*. The interest rate for a non-*Business Day* will be based on the most recent interest rate observed for the prior *Business Day*.

**Auction Technique:** We would offer floating rate securities through a single-price auction. Competitive bids would be accepted in the form of a negative or positive *Spread*, expressed in one-tenth of one basis point,<sup>10</sup> to be added to the *Index Rate*. The securities would settle at par, provided that the auction clears above the *Minimum Spread*. If the auction clears below the *Minimum Spread* of zero, then the *Spread* on the floating rate security becomes zero and the auction clearing spread is used as the *Discount Margin* for determining the settlement price.<sup>11</sup>

Treasury bill competitive bids are expressed as a discount rate, in increments of one-half of a basis point. However, these securities have maturities of one year or shorter. Accepting bids in increments of one-tenth of a basis point would be more reflective of our fixed rate notes, bonds, and TIPS programs, which are similar to the expected maturities of floating rate securities. We are interested in input from potential auction participants, as well as others, on this subject.

All other auction rules for floating rate securities would be consistent with current rules. Please comment on any problems that could arise from using the same rules.

**Auction Frequency and Settlement:** We contemplate issuing floating rate securities on a regular quarterly cycle, with potentially two re-openings in subsequent months following the original quarterly auction. We would appreciate comments on whether the floating rate securities should settle mid-month (like the three-year and ten-year Treasury notes and the 30-year Treasury bond) or end-of-month (similar to the two-year, five-year, and seven-year Treasury notes). We believe that auctioning and settling floating rate securities in the same week as similar maturity fixed rate securities, such as the two-year note, may provide greater transparency for market participants seeking comparative pricing between floating rate and fixed rate securities. On the other hand, a mid-month settlement might be preferable to cash management investors as well as corporations with mid-month tax

<sup>6</sup> This amount is derived from publicly available tri-party repo statistics from the Federal Reserve Bank of New York. It is the approximated sum of volumes of U.S. Treasury securities collateral (including Strips) and Treasury GCF (adjusted for double-counting).

<sup>7</sup> For more information on the DTCC Treasury GCF rate please go to <http://www.dtcc.com/products/fi/gcfindex/>.

<sup>8</sup> An example of this premium calculation can be found in Appendix B.

<sup>9</sup> Treasury announced at the August 2012 Quarterly Refunding that it is in the process of building the operational capabilities to allow for negative rate bidding in Treasury bill auctions, should we make the determination to allow such bidding in the future. No such determination has yet been made.

<sup>10</sup> A basis point is equal to one hundredth of a percentage point.

<sup>11</sup> An example of this premium calculation can be found in Appendix B.

liabilities. Please comment on the relative merits of these settlement conventions or whether an alternative convention would be preferable.

Section 356.24(c) of the Uniform Offering Circular states that, no later than the day after the auction, Treasury will provide notice of the amount to be charged (in principal and accrued interest) on the issue date. If the auction date is more than one day before the issue date, the amount of accrued interest for reopenings may not be known. That could be problematic if the initial *Index Rate* is not known by the day after the auction. We are considering changing this rule to state that we will provide this notification no later than the day before the issue date. Please comment on any operational issues this rule change might cause.

*Reopenings:* As stated above, we may reopen floating rate securities, subject to the same Original Issue Discount tax rules that apply to existing Treasury securities. A reopening would also be accomplished by an auction. Because the *Spread* will have already been established, we anticipate bids in a reopening would be in terms of *Discount Margin*,<sup>12</sup> as defined in Appendix B, carried out to one-tenth of a basis point. Existing floating rate securities trade on a *Discount Margin* basis in the secondary market. Because reopenings would not settle on a quarterly interest *Payment Date*, successful bidders in reopening auctions would be required to pay accrued interest. Please comment on any objection to using a *Discount Margin* for auction reopenings or any issues with the proposed pricing formulas found in Appendix B.

<sup>12</sup> See Appendix B.

Also, we are requesting comments on whether the larger amount outstanding per issue that would result from having several reopenings is important for market liquidity, or whether it would be more important to issue a new floating rate security each month.

*Maturities:* We intend to start our floating rate securities program with a two-year maturity. We anticipate strong demand from money market investors with weighted average portfolio constraints. A two-year maturity might also offer an appealing investment alternative for cash portfolios. We anticipate eventually issuing longer maturity securities and seek comment on the most appropriate maturity for both the initial and future phases of the program.

*Offering Amounts:* We are requesting comments on the appropriate size of the initial floating rate security auctions and potential reopenings, and on whether it would be preferable for the initial auction size to be larger than reopening offering amounts.

*Book-Entry Form and Systems:* The floating rate securities would be offered only in book-entry form. They would be issued and maintained in the commercial book-entry system operated by the Federal Reserve System, acting as fiscal agent for Treasury. We also would make floating rate securities available to be purchased through and held in TreasuryDirect®, a system designed primarily to enable investors to hold their book-entry securities directly with Treasury.

Eligible amounts for holding and transferring would be in minimums and multiples of \$100 of original par value for floating rate securities.

*Eligible Collateral for Banks Holding Treasury Cash Deposits:* We intend to

make floating rate securities eligible as collateral for depository institutions that hold Treasury funds. Valuation for collateral purposes would depend on the precise structure of the security.

*Stripping:* Stripping<sup>13</sup> a floating rate security is different from stripping a nominal fixed rate security because the future interest payments are unknown. We do not currently plan to make floating rate securities *Strips Eligible*. However, we welcome comments on whether a floating rate interest strip would appeal to investors and how it would be priced.

*Taxation:* Interest payments on floating rate securities would be included in the owner's taxable income when received or as accrued, in accordance with the owner's method of accounting for tax purposes. In general, the tax treatment of floating rate securities would be determined under the tax rules applicable to variable rate debt instruments.<sup>14</sup> Relevant tax issues, if any, would be addressed before the first auction of these securities.

We invite comments on any other issues relevant to the sale and issuance of floating rate securities. After we consider the responses to this Advance Notice of Proposed Rulemaking, we intend to issue a final rule amending the Uniform Offering Circular. Because the rule would relate to public contracts and procedures for United States securities, the notice, public comment, and delayed effective date provisions of the Administrative Procedure Act are inapplicable under 5 U.S.C. 553(a)(2).

**BILLING CODE 4810-39-P**

<sup>13</sup> Stripping means separating a security's interest and principal components so they can be traded separately.

<sup>14</sup> See 26 CFR 1.1275-5.

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**Appendix A—HYPOTHETICAL TERM SHEET**

I. ISSUER	U. S. Department of the Treasury
II. ISSUANCE	Floating Rate Securities
III. ISSUE DATE <sup>15</sup>	The last day of the month succeeding the Auction Date, subject to following Business Day convention.
IV. DATED DATE	The unadjusted Issue Date
V. MATURITY	2-year
VI. ORIGINAL ISSUE PRICE	Par (100 percent of face value)
VII. INTEREST:	
A. ACCRUAL PERIOD	From and including the Dated Date or last unadjusted Interest Payment Date to, but excluding, the next unadjusted Interest Payment Date.
B. COMPOUNDING	No
C. FREQUENCY OF INTEREST PAYMENTS	Quarterly
D. PAYMENT DATES	Principal will be paid on the maturity date as specified in the auction announcement. Interest will be paid on a quarterly basis. If any principal or interest payment date is a Saturday, Sunday, or other day on which the Federal Reserve Bank of New York is not open for business, we will make the payment (without additional interest) on the next Business Day.

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<sup>15</sup> Please note that the *Issue Date* is synonymous with the settlement date.

E. INTEREST RATE	Index Rate plus the Spread, floored at 0.000 percent.
1. INDEX RATE	
a. INDEX RATE (Option 1)	Treasury Bill Yield, defined as the ACT/360 simple yield of the most recent auction that matches the Index Maturity with an issue date preceding the beginning of the Accrual Period or most recent reset.
i. INDEX MATURITY	13-weeks
ii. INDEX RATE DETERMINATION DATES	The preceding auction for the U.S. Treasury Bill with the Index Maturity.
b. INDEX RATE (Option 2)	Treasury GC Rate, defined as a Treasury general collateral overnight repurchase agreement rate.
i. INDEX MATURITY	Daily
ii. INDEX RATE DETERMINATION DATES	For a Business Day, the prior Business Day. For a non-Business Day, two Business Days prior.
2. SPREAD	
a. MINIMUM SPREAD	Zero
3. MINIMUM INTEREST RATE	
	0.000%
F. RESET FREQUENCY	Daily
G. DAY COUNT	ACT/360
H. LOCK OUT PERIOD	None

VIII. BUSINESS DAY	Any day other than a Saturday, Sunday or a day on which the Federal Reserve Bank of New York is closed.
IX. STRIPS ELIGIBLE	No
X. CALCULATION AGENT	U. S. Department of the Treasury
XI. AUCTION TECHNIQUE	<p>A single price auction format in which a competitive bid must show a positive or negative Spread, expressed in one-tenth of one basis point, to be added to the Index Rate. Note that if the auction clearing spread is less than the Minimum Spread, then the spread on the floating rate security is set to the Minimum Spread and the auction clearing spread becomes the Discount Margin used to calculate the price.</p> <p>Treasury will first accept in full all noncompetitive bids up to \$5 million per bid received by the closing time specified in the offering announcement. Then competitive bids will be accepted, starting with the lowest spread to the highest spread needed to fill the public offering. The usual Treasury proration rules will apply if the amount of bids at the highest accepted spread exceeds the amount of the public offering remaining.</p> <p>Reopenings will be auctioned in the same manner, but with bidding on the basis of Discount Margin rather than Spread.</p>
XII. MINIMUM AND MULTIPLES TO BID, HOLD AND TRANSFER	The minimum to bid, hold, and transfer is \$100 original principal value. Larger amounts must be in multiples of \$100.
XIII. MAXIMUM NONCOMPETITIVE AWARD	\$5 million

## BILLING CODE 4810-39-C

**Appendix B—PRICING FORMULAS AND EXAMPLES**

The Discount Margin is the spread that would return a price of par if the existing floating rate security were being auctioned as a new issue. It is used to calculate the price (see formula in link below) of the floating rate security with an established *Spread*.

A link to formulas: <http://www.treasurydirect.gov/instit/statreg/auctreg/ANPRFRNformula.pdf>.

A link to examples: <http://www.treasurydirect.gov/instit/statreg/auctreg/DMLCalc.xlsm>.

**Please note:** These examples are for illustrative purposes only and are not meant

to convey any decision with respect to rounding and/or truncation.

**Matthew S. Rutherford,**  
*Assistant Secretary for Financial Markets.*

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