Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)\(^1\) appreciates the opportunity to provide feedback to the U.S. Treasury Department (“Treasury”) on its request for information on the potential issuance of floating rate notes linked to the Secured Overnight Funding Rate (“FRNs/SOFR”).\(^2\) As a general matter, SIFMA believes that the development of FRNs/SOFR would positively add to the suite of securities offerings made by Treasury—with a contribution to the Treasury’s goal of financing the U.S. debt at the lowest cost to taxpayers over time—and would signal further the market’s commitment to moving away from LIBOR and encourage other issuers to use non-LIBOR risk-free rates. SIFMA provides the following responses to the Treasury’s specific questions and believes that, with the appropriate structure, FRNs/SOFR would be expected to be a successful addition to Treasury’s offerings.

**Market Demand**

1.1 *Which types of investors would be the primary buyers of Treasury SOFR-indexed FRNs?*

We believe the pool of interested investors will be similar to those that already invest in other Floating Rate Notes (“FRNs”), however structural considerations (see below) will impact the attractiveness of the new security to investors. As a general matter, we believe that 2a-7 money market funds and government money market funds would be significant participants in a

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\(^1\) SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [http://www.sifma.org](http://www.sifma.org).

FRN/SOFR market. We believe that a 1-year tenor, as suggested by the Treasury, would elicit demand from both current investors and, incrementally, newer investors because there is currently limited supply of 1-year instruments. We also believe, importantly for demand from the money fund complex, that a 1-year tenor would have a smaller impact on the funds' portfolio maturity requirements, such as weighted average life ("WAL").

Additional investors—and new investors—could include investors seeking specific SOFR exposures. These would include retail investors, banks' purchasing high quality liquid assets, repo trading desks or Government Sponsored Entities ("GSEs"), however we believe government money market funds will be the primary investors. Additional new demand for a FRN/SOFR issuance in the 1-year tenor sector could be sourced from Offshore Investment Vehicles that are currently unable to invest in tenors longer than 397 days. Using the SOFR index published by the Federal Reserve Bank of New York ("FRBNY"), rather than simply referencing the benchmark directly, may have some impact on demand from market participants who observe rating agency requirements.

We believe there will be circulation of demand between the current 13-week and prospective FRN/SOFR offerings. We do not believe this new offering will impact the current market share of 13-week offering.

1.2 Please estimate annual demand for Treasury SOFR-indexed FRNs.

SIFMA and its members are not able to accurately estimate the aggregate demand for these FRNs/SOFR as that demand may depend on structure and other characteristics of the securities, however, we believe the demand for the new security will be significant. That said, structuring the FRN/SOFR as a money market instrument will significantly increase its demand.

Pricing and Liquidity

2.1 Would introducing a FRN/SOFR help Treasury finance the government at the lowest cost over time?

Given the success of the 13-week T-bill FRN as highlighted in the notice, we believe that a FRN/SOFR can contribute to savings—because, if properly structured, the new security may be attractive to new investors for Treasury securities. These new investors may help Treasury continue to finance at the lowest cost over time by deepening the overall demand for Treasury securities. Further, despite a minimal upfront cost, Treasury will experience long-term benefits, and potential cost savings, from developing the market for SOFR linked products to assist with a transition away from LIBOR. By issuing FRNs/SOFR, Treasury will aid in standardizing the SOFR-indexed FRN market structure, thus providing a degree of standardization in this sector of the curve.
2.2 How would you expect a FRN/SOFR to price relative to a comparable maturity 13-week T-bill FRN?

We believe, as least initially, T-bills will likely see more demand as the market is familiar with them. Until FRNs/SOFR establish a track record, we can see them trading as a discount to the 13-week FRN but believe that gap will close over time. An important consideration with respect to price will be a consistent supply of FRNs/SOFR in the 1-year tenor. Also, accommodations for offshore demand will ultimately contribute to competitive pricing.

2.3 Would there be impacts on cost to Treasury from spikes in SOFR?

There may be minimal, but not material, additional costs to Treasury from spikes in SOFR. Generally, SOFR spikes have occurred at quarter and year-end and Treasury can minimize their impact through issuance and interest payment timing. We would stress, as noted by the Alternative Reference Rate Committee (“ARRC”) after the September 2019 spike in SOFR,³ that averages of SOFR have shown stability over longer time frames so very short-term spikes should have minimal impact on Treasury. In addition, structure considerations, such as timing of payments and calculation of interest (see below), could ease the potential spike in costs to Treasury.

2.4 Impact of market stress on SOFR and cost to Treasury?

In a potential period of market stress, the interest costs to Treasury for FRNs/SOFR would be similar to those attributable to T-bill FRNs. Notably, recent periods of market stress have shown significant increases in volumes of transactions underlying SOFR. This further demonstrates the robustness of this rate.

2.5 How liquid would FRN/SOFR be in secondary markets?

SIFMA expects the secondary market liquidity profile of FRNs/SOFR to be similar to T-bill FRNs. We believe, as well, that the liquidity of the new instrument will be enhanced as the market becomes more familiar with the product provided that SOFR becomes widely adopted as the benchmark rate instead of LIBOR.

³ “These averages of SOFR have been quite smooth and can be easily referenced in financial contracts, as demonstrated by the growing use of SOFR in futures, swaps, and floating-rate debt.” ARRC, Frequently Asked Questions #16, at 9 (June 2, 2020), available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf.
Structure

3.1 What are the primary considerations Treasury should evaluate when structuring a Treasury FRN/SOFR?

The structure of the new security will be important to its success in meeting Treasury financing needs and achieving the Treasury’s goal of lowest cost to the taxpayer over time. As a preliminary matter we suggest that Treasury look to current FRNs that are available in the market and that link to SOFR in determining the appropriate structure for the new security. This would allow for investors that have comfort with certain more standardized features of current offerings to easily adapt to, and invest in, Treasury FRNs/SOFR. One significant example includes the GSE FRN offerings as these have been viewed favorably by the market and are familiar to many of the expected investors in FRNs/SOFR.

In designing the security, the Treasury should consider the following as we believe these could have the most impact on the success of the new security:

- Considerations of when auctions would occur – we recommend mid-month dates rather than month ends as an example;
- Consideration of the impact of the structural features on secondary market liquidity and trading activity;
- Consideration of a FRN/SOFR yield floor of 0% (as is the case for T-bill floaters) so that an investor will never owe a payment to Treasury;
- Consideration on floors – it would be beneficial for this SOFR FRN to have an aggregate/cumulative coupon floor, and not account for individual SOFR fixing floors;
- How the timing of interest payments may impact certain investor classes;
- Operational features that will ease uptake of the new security and should be consistent with current similar offerings that have been seasoned in the market would provide efficiency and ease of entry for market participants;
- Ease of calculation for settlements – we recommend mid-month settlements and maturities;
- Incorporation of two business day lookback with observation period shift to ensure this closely mirrors the RFR derivative market conventions and includes each of the individual SOFR resets;
- Market consistency across derivative and cash products ultimately assisting with hedging considerations;
- Consideration should be given to using the SOFR Index published by the Federal Reserve Bank of New York (provided that it has been approved by the rating agencies). This will ensure consistency of calculation.

3.2 Is a 1-year final maturity for original issuance of a Treasury FRN/SOFR preferable?

SIFMA recommends a one-year maturity. As noted above, we believe there is currently limited supply at this tenor and additional supply could attract additional investors and demand.
3.3 *Is a quarterly issuance frequency with two reopenings appropriate for a Treasury FRN/SOFR?*

This decision relies on the SOFR-indexed FRN's maturity. Should Treasury issue FRNs/SOFR with a two-year tenor, we recommend a quarterly issuance cycle with two reopenings. Should Treasury issue FRNs/SOFR with a one-year tenor, we recommend a monthly issuance cycle with monthly reopenings and a minimum offering size of $20 billion to ensure ample supply and to encourage secondary market liquidity.

3.4 *When during the month should Treasury FRNs/SOFR be auctioned?*

Treasury should auction the FRNs/SOFR in the middle of the month to avoid conflicting with the issuance of the 13-week T-bills at the end of the month. This will ensure investors can preserve purchasing power and limit cannibalization of demand for other securities. Issuing SOFR-indexed FRNs in the middle of the month will also limit the impact of spikes in SOFR, which occur most frequently at the end of the month, particularly at quarter-end.

3.5 *Should interest be calculated based on a simple average or compounded average of SOFR?*

Calculating interest based on a compounded average would be better in the long-term and preferred by SIFMA as it more accurately reflects the time value of money than a simple average. In order to ease any operational issues in implementing a compound calculation, Treasury should reference a rate based on a SOFR Index published by FRBNY to ensure consistency of calculation. Using the SOFR Index may help ease any technical or structural issues that may limit the ability of most money market funds to purchase SOFR-indexed FRNs with interest based on a compounded average.

3.6 *What coupon payment frequency should be used for a Treasury FRN/SOFR?*

Coupon payments on the FRNs/SOFR should be quarterly coupon payments, similar to the T-bill FRN (and other FRN securities) with coupon and principle payments in the middle of the month. This will insulate investors from month and quarter end technicalities (e.g., balance sheet constraints) that could inflate the cost of securities. Additionally, for the reasons described in response to question 3.4 above, middle of the month coupon payments will avoid conflicts with the T-bill FRNs and potential SOFR spikes.

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3.7 Should index rate reset daily, weekly or some other frequency?

Treasury should reset the index daily. The SOFR index published by the Fed should be utilized to calculate the respective coupon amounts by referring to the two required dates on the FRB’s official website.

3.8 Should Treasury incorporate a lock out or payment delay?

Treasury should utilize a structure commonly known as the ‘Compounded SOFR indexed FRN with a two-business day observation period shift’. The FRN market has expressed a preference for a lookback that also shifts the SOFR observation period. With this structure, the period over which SOFR is observed is “backward-shifted” (e.g., with a two-business day shift, the observation period would start and end two U.S. business days prior to interest period start and end dates). The backward-shift applies to both the daily SOFR rates and the weighting of those rates, so the SOFR rate and weighting are determined based on the day of the observation period rather than the day of the interest period. This ensures that the appropriate weighting is assigned to each rate depending on its calendar day.

In order to utilize the FRBNY published SOFR Index with an FRN that has a lookback, the lookback must be applied with an observation period shift. A lookback without an observation shift cannot use the SOFR Index. Because a lookback with an observation shift uses all SOFR resets (i.e., it is not combined with any lockouts), parties can align FRN interest accruals with uncleared hedges that have established the same SOFR observation period. A lookback with a shifted observation period also ensures that the SOFR applied for weekends and holidays is consistent with the repo and swap market.

With the payment delay structure, accrued interest for secondary market trades cannot be determined prior to settlement, unless a separate convention is implemented (e.g., a lockout). This could lead to differences in accrued interest for trading vs. actual accrued interest earned by holding the notes. Implementation of the SOFR Index for a payment delay structure is less straightforward because the last coupon period generally doesn’t involve a payment delay (i.e., different structure for the final interest period).

3.9 What Treasury contingencies should be incorporated into the terms of Treasury FRN/SOFR in case of unavailability of SOFR?

Treasury should follow FRBNY’s data contingency procedures in the event SOFR is temporarily unavailable for the SOFR-indexed FRN. Additionally, Treasury should consider an alternative rate, such as T-bill FRN rate. If a SOFR Index is not published on a temporary basis

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5 The weighting is intended to account for calendar days on which SOFR is not published and on most days, the weighting of a rate will be equal to “1,” however a daily SOFR that represents a Friday during the observation period will generally be given the weight of “3” (to account for Saturday and Sunday) and a daily SOFR representing the day before a holiday during the observation period will also be given a weight greater than 1.
but the daily SOFR overnight rates continue to be published, SIFMA suggests that the compounding formula be used to calculate the compounded rate over the relevant observation period. We believe, as well, that it is important to include robust fallback provisions in the event that SOFR is permanently discontinued.  

Existing 13-week FRN

4.1 What changes should Treasury make to the current FRN issuance program?

Treasury should not make changes to the current 13-week T-bill FRN. Decisions around several of the structural considerations above (timing of auction, for example) can help in easing competitive concerns between the two FRNs and thus, given the success of the 13-week FRN, changes should not be necessary.

4.2 Should Treasury issue FRNs indexed to both indices?

While we believe that the market can support both the 13-week T-bill FRN and the FRNs/SOFR, Treasury should assess continuing demand for both securities after introduction of FRNs/SOFR. We believe investors will continue to want to have exposure to both the T-bill rate (and the 13-week tenor) and SOFR (and the 1-year tenor). Consolidation into one index should only be undertaken after careful consideration of market demand to ensure overall lowest cost of funding over time.

4.3 Which, if not enough demand for both FRNs, would generate more long-term demand?

We find it difficult to evaluate this until the new security has been introduced. Treasury should wait to make this decision until it can review the demand profiles of both Treasury FRNs. SIFMA preliminary thinks the T-bill FRN will initially have the most demand due largely to familiarity and the current installed investor base, but the SOFR-indexed FRNs could become more popular over time as the market becomes more comfortable with SOFR as a standard risk free rate.

4.4 Should Treasury move 13-week Treasury bill FRNs to one year?

Treasury should not move the 13-week T-bill FRNs to one year. We believe that creating a one-year FRN/SOFR will draw in investors looking for a one-year instrument as well as those looking for SOFR exposure. Having the Treasury bill FRN competing directly at this tenor could dilute the demand for the SOFR linked note and the 13-week security.

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Market Transition

5.1 What proportion of likely investors is currently operationally ready to purchase FRN/SOFR?

SIFMA members note that customers are generally ready to purchase FRNs indexed to SOFR and there are no structural issues that require a lead-time to allow for operational readiness. Many investors already purchase SOFR linked bonds and should be operationally ready to participate assuming, in general, consistent characteristics with other SOFR-linked products. According to the Credit Roundtable’s survey, about 86% of respondents, indicated a willingness to purchase a Treasury SOFR FRN if available in the next few years.

SIFMA additionally recommends Treasury adopt the proposal expeditiously to assist the market with the transition from LIBOR to SOFR and to broaden the product suite available to Treasury security investors. Treasury may consider alerting the market to its plan for the security as part of the next refunding announcement in August. We believe that could, if consistent with Treasury’s financing needs, result in initial auction announcements as soon as the 4th quarter refunding in November. As noted throughout, and consistent with the Credit Roundtable Survey, SIFMA believes that market participants—both primary dealers and investors—are ready for Treasury to proceed with auctioning SOFR-indexed FRNs consistent with its financing needs.

5.2 What impact would FRN/SOFR have on market wide transition away from LIBOR?

SOFR-indexed FRNs would support the overall market transition away from LIBOR to SOFR. Importantly, the security conventions adopted by Treasury will aid with creating consistency across the market and will minimize any further SOFR FRN market fragmentation. A successful launch of FRNs/SOFR would reinforce the consistent message of policy-makers that alternatives to LIBOR must be implemented. Treasury securities, as the most important benchmark in the global marketplace, would be an important example of the use of alternative rates. Treasury would also, given the high profile of the Treasury market, be an indicator of comfort with non-LIBOR rates and would encourage other market participants/issuers to adopt alternative rates.

Conclusion

For the reasons stated above, SIFMA believes that Treasury issuance of SOFR-indexed FRNs will assist with the transition from LIBOR to SOFR while presenting minimal additional cost to Treasury. SIFMA anticipates sufficient demand, from current and new investors, for one-year SOFR-indexed FRNs provided that the securities are structured in the manner described above. Importantly, these SOFR-indexed FRNs can be issued concurrently with existing T-bill FRNs (assuming, as noted above, a non-conflicting auction schedule). SIFMA also believes that the issuance of SOFR-indexed FRNs will, as the market becomes familiar with the security, new

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investors participate in the Treasury market and Treasury’s structure is further adopted by the market, aid in achieving Treasury’s financing mandate of funding the national debt at the lowest cost over time.

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SIFMA greatly appreciates Treasury’s considerations of the issues raised above and would be pleased to discuss these comments in greater detail. If you have any questions or need additional information, please contact me at 212-313-1124 or rtoomey@sifma.org.

Sincerely,

Robert Toomey
Managing Director and
Associate General Counsel