

Scott E.D. Skyrms  
[scott.skyrm@yahoo.com](mailto:scott.skyrm@yahoo.com)  
[www.scottskyrm.com](http://www.scottskyrm.com)

January 22, 2013

Department of the Treasury  
Bureau of the Public Debt  
Government Securities  
Regulations Staff  
799 9th Street NW.  
Washington, DC 20239-0001

**Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds**  
**31 CFR Part 356**  
**[Docket ID: FISCAL-BPD-2013-0001]**  
**Proposed Rule**

**Background**

The Treasury Department is considering the issuance of a Floating Rate Note (FRN). Please find my comments below.

**Recommendations**

Index Rate – The index should not be a T-bill index, nor the GCF Repo index. A Combined Inter-Dealer Broker Repo Rate (CIDBRR) based on the trading averages for all general collateral (GCF and deliverable) is the best and only long-term solution to support a liquid market and minimize taxpayer costs. [See Additional Discussion below]

ACT/360 or ACT/365 – ACT/360 is the best calculation because it matches repo rate and swaps floating rate calculations. Trading the FRN versus the repo market and repo futures contracts will create a liquid secondary market that will help minimize interest rates for the Treasury.

Reset frequency – A daily reset is best, which is not practical with weekly 13 week T-bills. A Repo rate based on the one day prior rate is best.

Frequency of Interest Payments - Quarterly coupon/interest payments are best because they minimize the compounding disadvantage to the buyer, and most FRN's pay quarterly. There should be no "Lock Out Period," given that settlement and

processing systems can sufficiently handle coupon payments one day after a rate change.

Minimum Interest Rate – A rate floor of 0% is appropriate. It is highly unlikely that average GC Repo rates would ever trade below 0%. Since I began keeping Repo market data in March, 1991, Overnight GC has never averaged negative, and only averaged at 0.0% three times, all in July, 2011, immediately following the conclusion of the QE3 program.

Auction Frequency and Settlement – The FRN's should initially be 2 year notes, then expanded to 5 year notes and finally 7 year notes, all Treasury issues with an end-of-month coupon/maturity cycle.

Automatic Reopenings – All seasoned 7 year FRNs should automatically be reopened as 5 year FRNs and all seasoned 5 year FRNs reopened as 2 year FRNs. This will create large liquid FRN issues with same the maturity and coupon payment dates.

Stripping – Stripping should be allowed and fungible with other FRN and fixed rate coupons and principals.

### **Additional Discussion**

I believe a FRN will be extremely good for the overall Treasury and Repo markets:

- It will allow another trading tool for floating rates, which is especially important now given that the recent LIBOR scandal has undermined the integrity of that market.
- Repo interest rate swaps (fixed Repo rates versus floating Repo rates), a Repo futures contract, spread trading the fixed-rate Treasuries vs. floating-rate Treasuries will allow relative value trading opportunities for Treasury FRN's and keep the secondary FRN market highly liquid.
- I believe the existence of Treasury FRNs will create a competing market for Interest Rate Swaps. With the changes in the IRS market (moving onto exchanges, capital/margin requirements, LIBOR scandals and less confidence with LIBOR rates), Treasury fixed-rate notes can be traded against Treasury FRNs<sup>1</sup> and create a synthetic risk-free IRS. U.S. Treasury FRNs combined with U.S. Treasury fixed rate notes will possibly dislodge parts of the LIBOR based IRS market.

---

<sup>1</sup> By being long a Treasury fixed-rate note and short a Treasury FRN, traders can create a synthetic IRS with Treasuries where they are receiving a fixed interest rate and paying a floating interest rate. The trade can be done opposite way to pay a fixed rate and receive a floating rate.

The Treasury is considering two floating rate indexes:

1. The 13-week T-Bill auction stop out rate
2. A Treasury general collateral overnight repurchase rate

Problems With The T-Bill Index Rate

- The T-bill stop out rate represents interest rates in the "bill" market, and not the overall Treasury market which includes Notes and Bonds. T-Bill rates are the specific to the prices of bills, and that market has its own supply and demand dynamics including different buyers and sellers.
- Whereas the FRN would specifically be a "Note," the Treasury should consider a Floating Rate Bill if they prefer the T-bill rate.
- T-Bill prices are highly susceptible to a flight-to-quality premium during a time of crisis, liquidity fears, and credit risk fears, so a T-bill rate index would experience distortions during some periods of time. For example, during the financial crisis, the spread between OIS and 3-month bills widened to more than 150 basis points<sup>2</sup>. In addition, T-bill rates experience a mild rate premium distortion during quarter-end and year-end. Knowing the Treasury FRN rates will be soft around each quarter-end combined with the uncertainty of receiving extremely low rates during a crisis means a T-bill index rate Treasury FRN might not perform well from an investor's point of view, trading cheap to relative market rates and the Treasury (taxpayers) might end up paying higher interest rates to compensate investors.
- The T-bill auction stop-out rate is currently a weekly index, which, from the start, means there are problems changing, modifying, and maintaining it as an overnight index rate.

Repo Index

- The GC Repo rate specifically represents the overnight supply and demand for U.S. Treasuries, including Bills, Notes, and Bonds.
- GC Repo is a mature market with actual transacted market trading data available on a daily basis.
- The Fed can intervene in Repo market through various policy transactions.
- Derivatives are developing in Repo, including Repo swaps, Repo futures, and these products will help create better liquidity for the Treasury FRN.

---

<sup>2</sup> William O'Donnell, John Briggs, RBS Securities, Inc., "March 19 Public Input on the Development and Potential Issuance of Treasury Floating Rate Notes," April 18, 2012.

DTCC GCF Index - Depository Trust & Clearing Corporation (DTCC) publishes the Treasury General Collateral Finance (GCF) rate index, which represents tri-party Treasury GC repo transactions traded between dealers.

### Problems With GCF Repo Index

- The Federal Reserve Bank of New York estimates total GC and GCF tri-party together to be \$650 billion<sup>3</sup>, whereas the U.S. Treasury securities cleared at DTCC as GCF is estimated between \$100 billion to \$200 billion<sup>4</sup> a day. All total, GCF is between 15% and 30% of all Treasury collateral tri-party trading. When looking at deliverable and GCF trading in the Inter-Dealer Brokers' markets, the GCF Repo Index only represented 10%<sup>5</sup> of all GC (deliverable and GCF) repo trading daily as of a year ago. The GCF proportion of all GC trading has increased in the past year, At best GCF represents no more than 40% of the overall GC market.
- GCF Repo Rates trade at least 1 basis point above deliverable GC Repo. That is because GCF trades being tri-party transactions, the Repo "sellers" are willing to pay a premium (higher rate) because they're able to pledge small Treasury collateral pieces, can allocate the collateral later in the day, and it allows them to be short overnight GC Repo rates during the day.
- Since GCF Repo rates trade above the equivalent deliverable GC Repo rates, the Treasury will pay higher rates which increases the costs to taxpayers. Just 1 basis point annually is approximately \$10 million for every \$100 billion of FRNs outstanding. If FRNs eventually become 10% of all U.S. Treasury debt outstanding, that 1 basis point discount could add up to over \$150 million additional expense paid by U.S. taxpayers annually.

Combined Inter-Dealer Broker Repo Rate (CIDBRR) <sup>6</sup> - A Treasury GC Repo Rate Index representing all tri-party and deliverable repurchase agreement (repo) transactions is not currently published, it is being developed.

- A combined overnight Repo rate index which represents the entire GC Repo market must be created. That index would represent a liquid, traded rate with transparent pricing from multiple sources. A Repo index rate provided

---

<sup>3</sup> Federal Register / Vol. 77, No. 234, December 5, 2012, page 72279

<sup>4</sup> HSBC, "Treasury Floating Rate Notes," April 2012, page 20

<sup>5</sup> Priya Misra, Bank of America Merrill Lynch, "Public Comment on Treasury Floating Rate Notes," April 18, 2012.

<sup>6</sup> Scott Skyrms, LLC is currently engaged in discussions with the IDB repo brokers and CME to create a consolidated complete repo average published daily based on the above criteria. This index will be presented with 3 years of historical data.

by only one broker<sup>7</sup> would not represent the entire Repo market trading activity and give one broker a competitive advantage over other brokers and perhaps damage long-term liquidity in the Repo market if one broker creates a dominant position.

- It's better to have an index which represents the whole market, instead of a segment of it. Participants in the Repo market are in the process of creating a general collateral Repo rate index (CIDBRR) that includes all deliverable and GCF U.S. Treasury collateral, including bills, notes and bonds, but no TIPS and Strips. It will create a daily volume weighted index of the Repo brokers' deliverable and GCF Repo trades and capture the entire volume of IDB Repo market.
- Many customers and dealers in the Repo market already price Repo trades off the broker averages. This is a standardized method for pricing Repo trades which developed over the past few years.
- Other details of the broker consolidated average are not finalized. It can be 10:00 am average (which is already widely publicized and use by market participants), or an index of Repo trades during the entire day, like the federal funds effective rate.

The Treasury Department and Federal Reserve must not rush to choose an average based on current availability. Ultimately, the Treasury FRN must be based on the best average that represents the entire Repo market and not just a segment of it. Using a Combined Inter-Dealer Broker Repo Rate (CIDBRR) will create the most liquid FRN which will also minimize the interest rate on the Treasury FRNs and thus minimizes interest rates for U.S. taxpayers.

Scott E.D. Skyrms

---

<sup>7</sup> For example, suppose the index is based on only one broker source and they are unable to open their offices once day due to weather, terrorism, etc., then there would be no index rate in that product that day, creating a severe setback for pricing and liquidity.