

# Morgan Stanley

**January 22, 2013**

Mr. Matthew Rutherford  
Assistant Secretary for Financial Markets  
Department of the Treasury  
Bureau of the Public Debt  
Government Securities Regulations Staff  
799 9<sup>th</sup> Street NW  
Washington DC, 20239

## **Response to Department of Treasury Request for Comments on Floating Rate Note Program**

Dear Mr. Rutherford,

In response to the December 5, 2012 Advance Notice of Proposed Rulemaking soliciting comments on the Treasury Floating Rate Note (FRN) program, Morgan Stanley & Co. LLC (“MSCO”) outlines our views on specifics requested by the Department of Treasury (“The Treasury”).

### **Index Rate**

The Treasury is currently considering the 13-week Treasury bill auction high rate (the “Treasury Bill Yield”) or Treasury general collateral (the “Treasury GC Rate”) as a choice the for Index Rate. We believe the Treasury GC Rate would better suit the Treasury’s goal of reducing long term financing costs.

Within the context of the Treasury GC Rate, the Treasury has different alternatives. We believe that the Depository Trust & Clearing Corporation (DTCC) published Treasury Collateral Financing (GCF) rate (the “DTCC Treasury GCF Index Rate”) is the reference rate best suited to Treasury’s goals in issuing FRNs. This rate provides more transparency to market participants than its alternatives since it is based on publicly published market transactions. Liquidity may also be enhanced by virtue of the GCF futures market, which would serve as a natural hedge to FRNs. The higher level of transparency and liquidity in the new product should increase investor comfort in the new issuance and lower borrowing costs for the Treasury.

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If the Treasury chooses Treasury Bill Yield as the index rate, we recommend the 13-Week bill yield given the consistent supply and lower realized volatility of this maturity, which should help lower the cost of financing. Treasury bills have a long trading history and are currently widely used by a variety of investors. However, market dynamics of Treasury bills such as seasonality and the fact that Treasury can influence the supply of bills may make it less desirable to investors.

To the extent that Treasury decides on the Treasury Bill Yield as the index rate for FRNs, we recommend conversion to the High Rate be done via ACT/360 to match that of the underlying 13-week Treasury bill.

### **Reset Frequency and Frequency of Interest Payments**

We expect good demand for Treasury FRNs from money market 2a7 investors who are also large players in the Agency FRN market. Shorter rate resets should increase the appeal of Treasury FRNs to money funds since it reduces the weighted average maturity of their portfolio. Hence for Treasury FRN, indexed to the Treasury GC Rate, daily resets are preferable.

The Treasury is currently contemplating quarterly interest payments; we suspect that money funds with shorter investment mandates would find monthly coupon payments more attractive. We recommend monthly coupon payments, but are not opposed to quarterly coupon payments, which are the current norm for floating rate markets.

### **Lock Out Periods**

One business day notice of interest payment should be sufficient.

### **Minimum Interest Rate**

A minimum rate of zero would be necessary to ensure that investors do not have to make a payment to the Treasury in a negative interest rate environment. The interest rate received should be the maximum of the index rate plus the spread and zero. With the minimum rate at zero, the Treasury must ensure that the notes can be sold at a premium.

### **Minimum Spread**

A negative minimum spread is appropriate for both reference rates currently under consideration. With Treasury GC rates often trading above 13-week Treasury bill yields, we anticipate a negative spread to the reference rate. Even in the case of the 13-week bill as the index, negative rate spreads might be required in rising rate environments.

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### **Auction Technique, Frequency and Settlement**

We expect current auction guidelines for fixed rate notes such as auction style, maximum bid size, and bid increments to work well for Treasury FRNs from an operational standpoint. A regularly scheduled auction we believe would be most attractive to investors. We recommend monthly auctions of Treasury FRNs.

Larger issue sizes should result in greater market liquidity, likely lowering borrowing costs. Hence we recommend holding an initial auction, followed by two re-openings. From our standpoint as a primary dealer, it may be easier if the Treasury FRN auctions coincide with the monthly bill cycle as opposed to coupon issuance cycle. This is especially the case if Treasury bill issuance decreases as Treasury FRN issuance starts to ramp up, as FRNs could fill the resulting demand gap during bill auction days.

### **Issuance Size**

Issuance size should strike a balance between liquidity and investor demand. We believe an initial issuance size of \$5 – 10bn with two subsequent monthly re-openings of comparable size is appropriate. This would put Treasury FRN issuance sizes somewhere in-between large Agency FRN and TIPS issuance sizes.

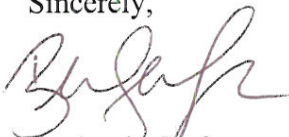
### **Maturity**

We envision initial demand for Treasury FRNs to come from money market funds and short duration investors. Hence, 1-year or 2-year maturity Treasury FRNs are most appropriate at the outset.

Demand for longer maturity FRNs, out to a 5-year maturity, will likely come from a different investor base than short dated FRNs, owing to maturity restrictions on holdings of 2a7 accounts. Therefore, we believe more time is needed for the market to gain comfort with Treasury FRNs before the Treasury expands issuance to longer maturities. Presently, we believe syndicated issuance will likely be more appropriate for the longer maturity Treasury FRNs; however, we recommend that the term be re-evaluated once the likelihood of a 5-year maturity issuance materializes.

Please feel free to contact me with any questions, concerns or feedback.

Sincerely,



Benjamin Seelaus  
Managing Director - Head of UST Trading