

# Presentation to the Treasury Borrowing Advisory Committee



UNITED STATES  
DEPARTMENT OF  
THE TREASURY



U.S. Department of the Treasury  
Office of Debt Management  
April 29, 2008

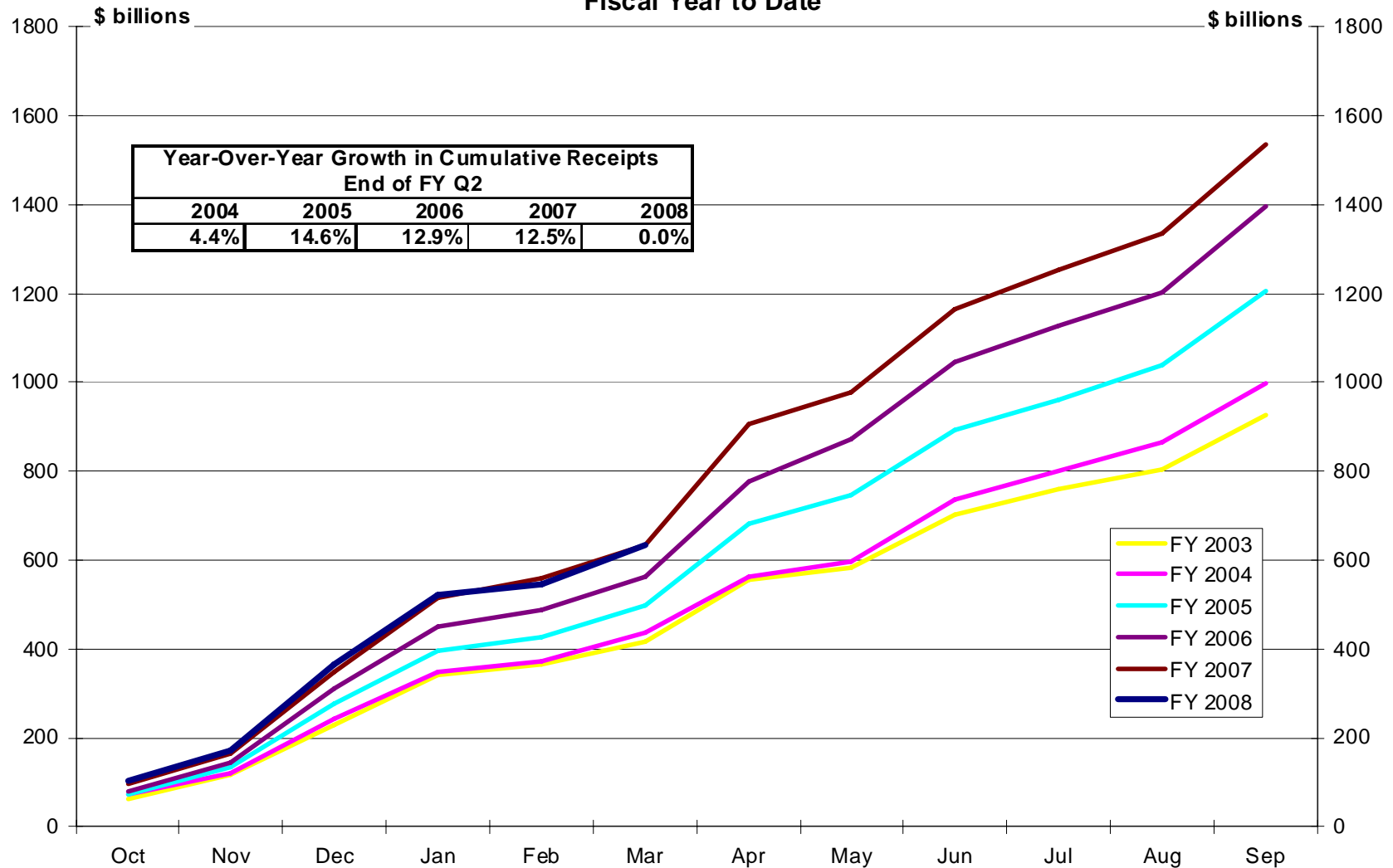
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# Fiscal Outlook



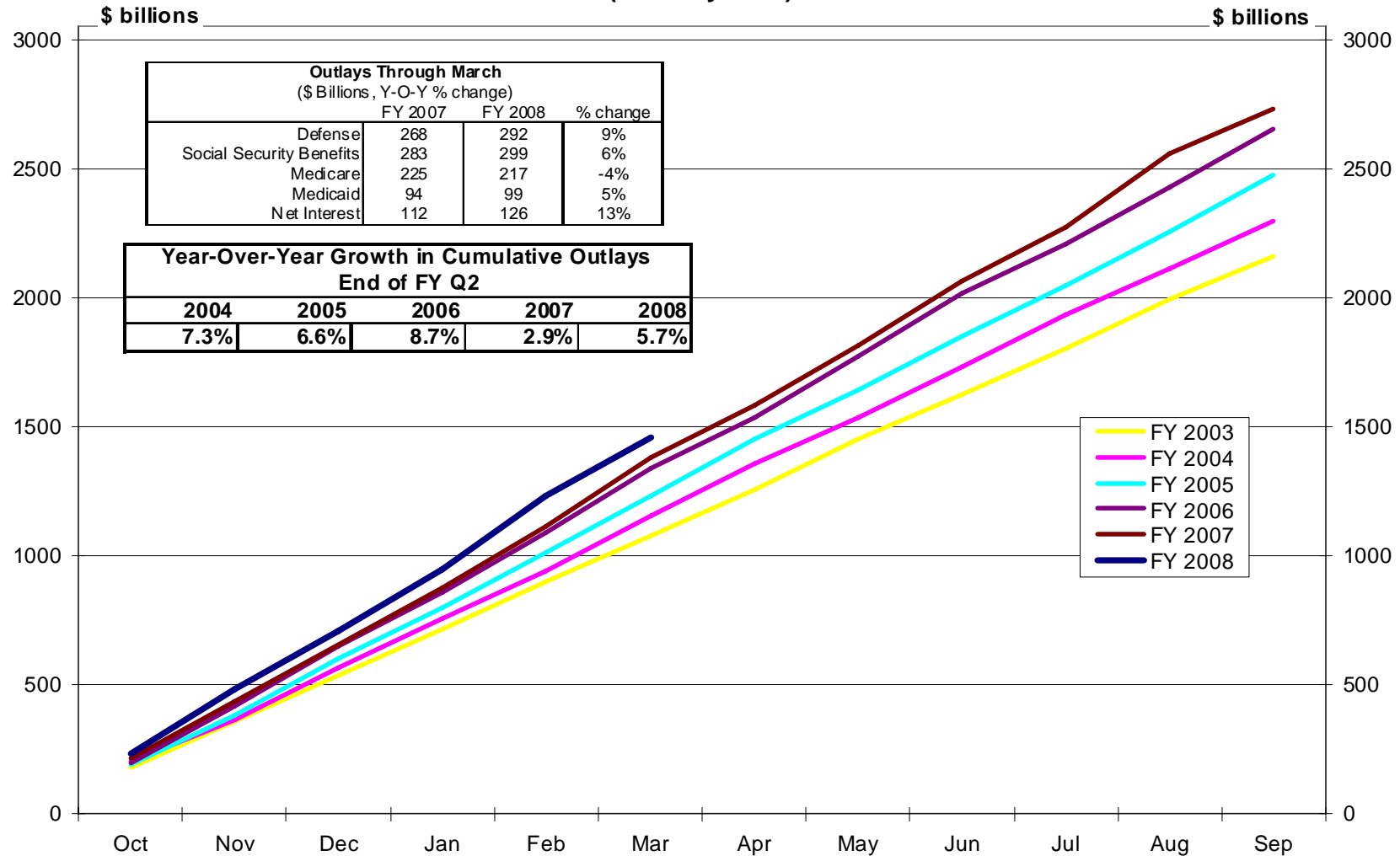
# Year-over-year growth in revenue from individual and corporate tax receipts is now flat through FY08 Q2

Individual and Corporate Tax Receipts  
Fiscal Year to Date



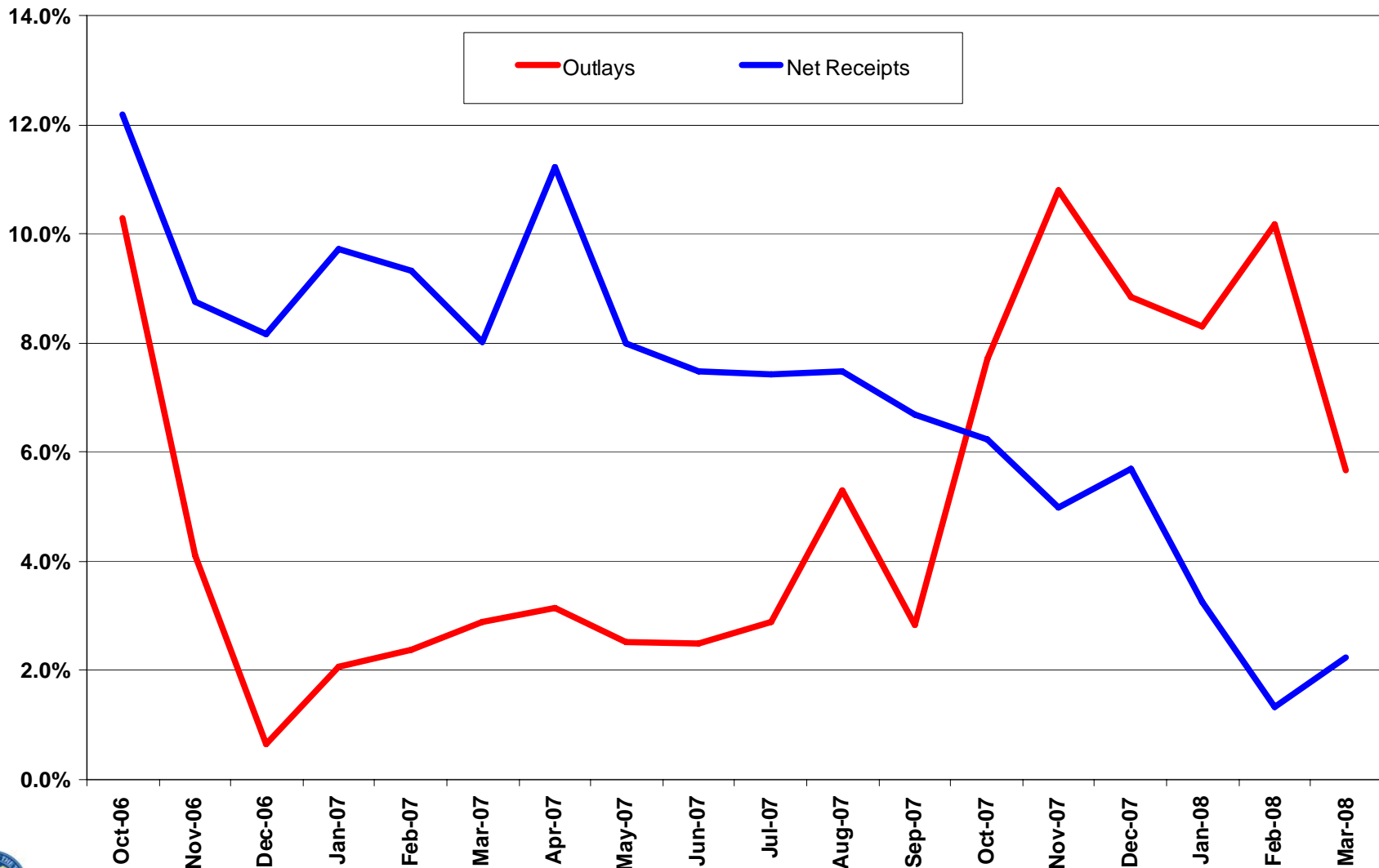
# Growth in outlays has increased versus FYTD 2007

## Total Outlays Fiscal Year to Date (monthly data)



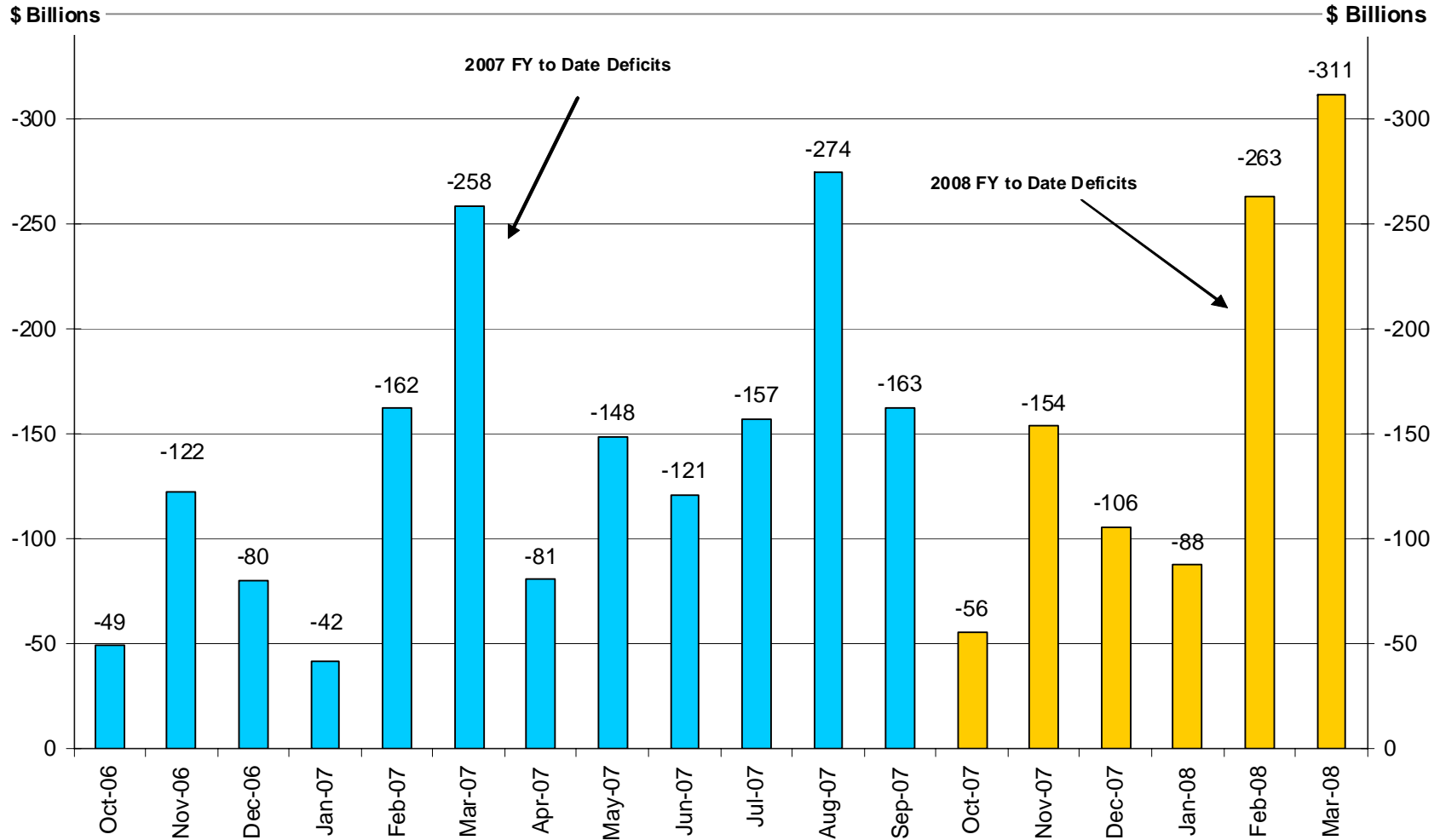
# Year-over-year growth in outlays has exceeded that of receipts since October

Federal Outlays and Net Receipts  
Year-Over-Year % Change



# Borrowing needs have increased considerably since the beginning of the fiscal year

Fiscal Year to Date Deficits  
(monthly data)



# Primary Dealer Estimates of the FY 2008 deficit have risen from \$203 billion in November 2007 to \$414 recently

## FY 08 Deficit Estimates

\$ billions

	Primary Dealers*	CBO	OMB
<b>Current:</b>	414	396	410
<b>Range based on average absolute forecast error</b>	362-466	319-473	302-518
<b>Estimates as of:</b>	April 08	March 08	February 08

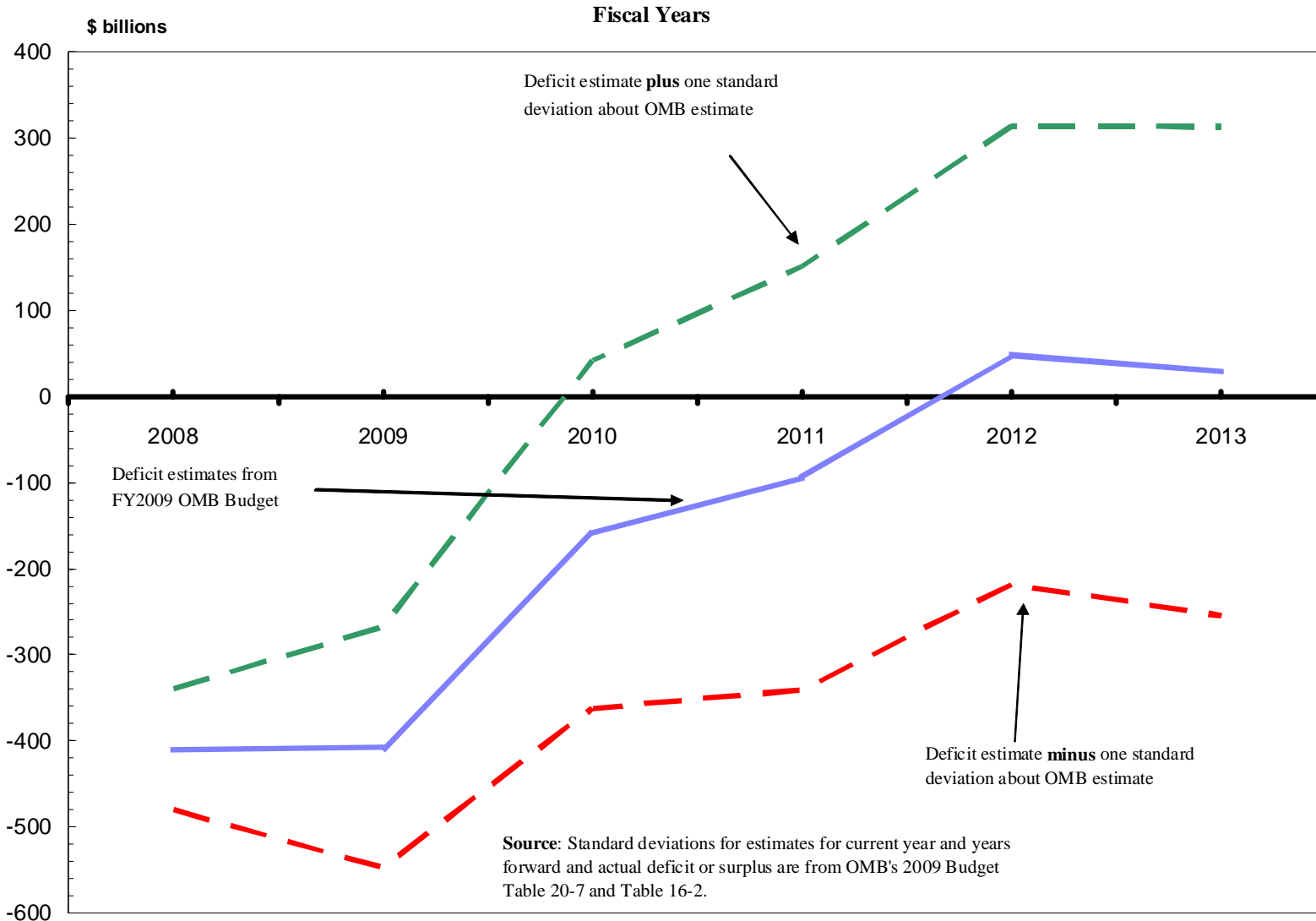
Note: Ranges based on errors from 2003-2007.

\* Primary Dealers reflect average estimate.



# The longer the forecast horizon, the greater the uncertainty surrounding deficit estimates

Error Bands About Current Deficit Estimates

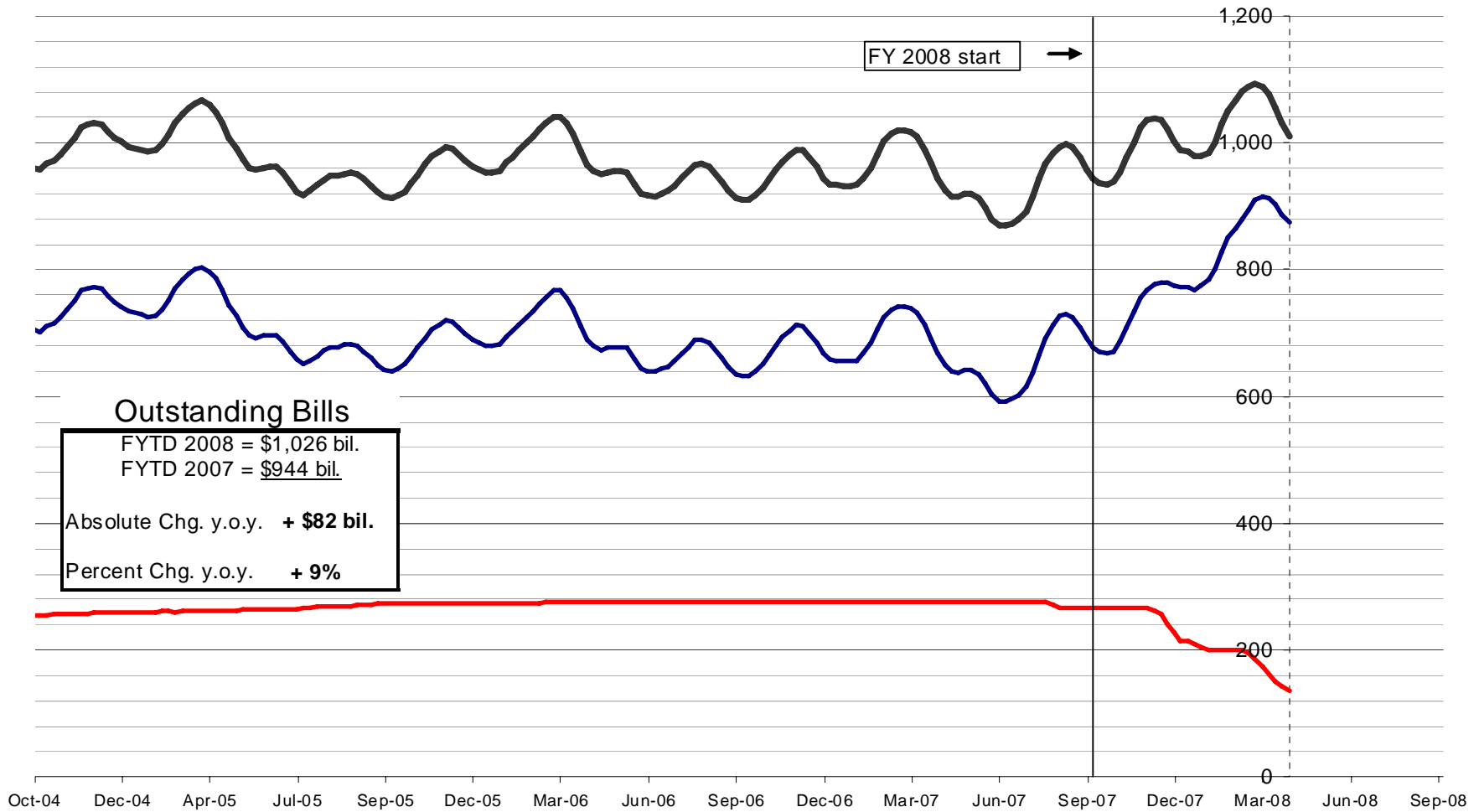




# SOMA bill redemptions have exerted upward pressure on private bill issuance

Outstanding Bills FY05-FY08

— Priv Bills — SOMA — Total



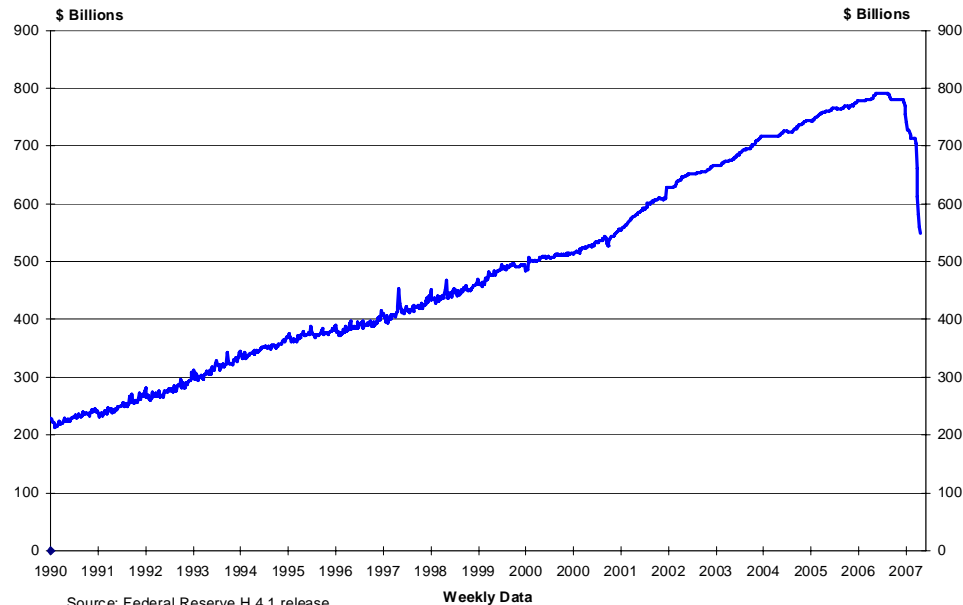
# Since the beginning of FY2007, the Fed's holdings of Treasuries have declined by \$230 billion as new liquidity tools have been introduced

Federal Reserve Liquidity Tools and Outright Treasury Holdings								Fiscal Year to Date Change
(Monthly Averages, \$ Billions)								
Liquidity Tools	October	November	December	January	February	March	April 16, 2008	
TAF	0	0	0	44	60	70	100	100
PDCF	0	0	0	0	0	23*	26	26
Discount Window	0	0	3	2	0	0	9	9
28-day RPs	0	0	0	0	0	60**	70	70
Currency Swaps	0	0	18	24	36	36	36	36
TSLF	0	0	0	0	0	0	129	129
<b>Total</b>	0	0	21	68	96	189	370	370
Outright Treasury Holdings	780	780	770	728	713	682	549	-231

\* 2-week average

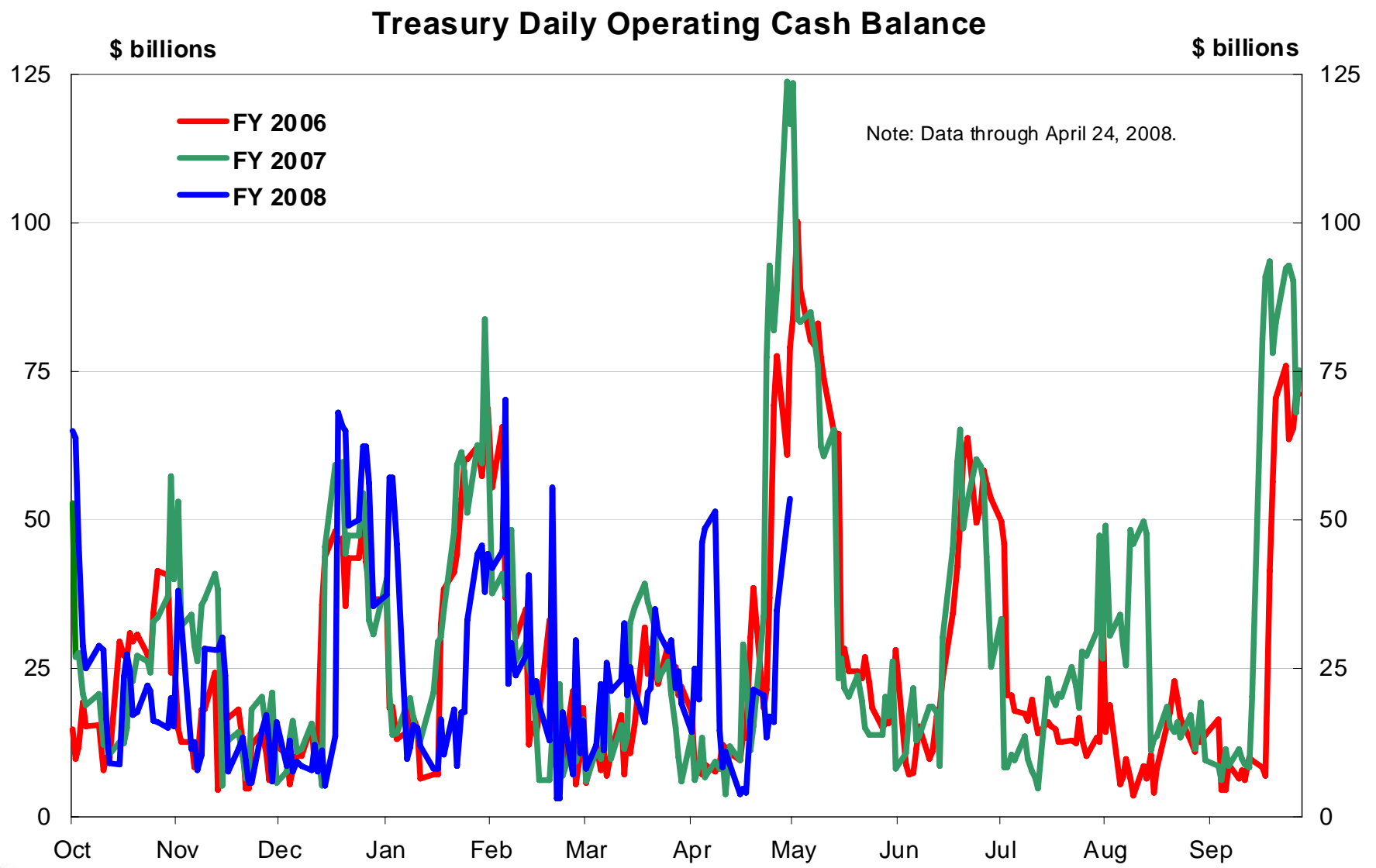
\*\* Outstanding end of March

Federal Reserve Outright Holdings of Treasury Securities



Source: Federal Reserve H.4.1 release

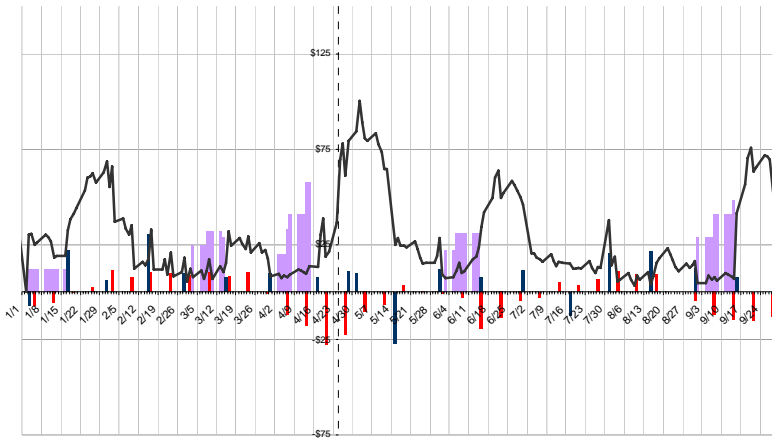
# Mitigating volatility in cash balances resulting from net receipts, redemptions, and other factors remains challenging



# Rapid growth in marketable financing needs has led to increasing dependence on cash management bills

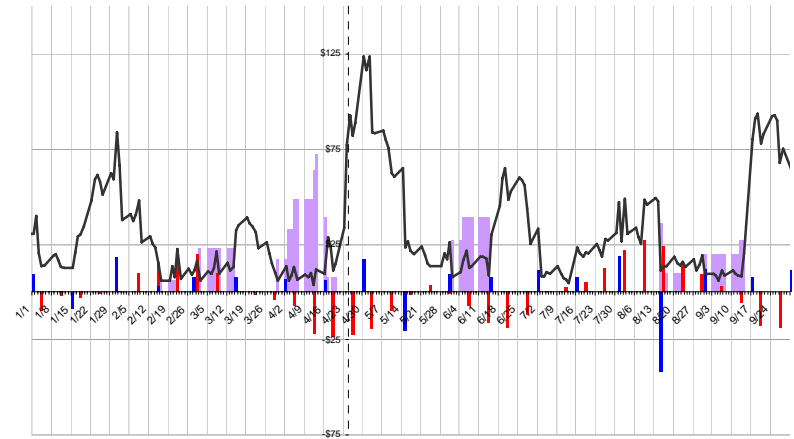
Near Term Financing Plan  
FY 2006

— CMBs — BillFin — CpnFin — OpBal



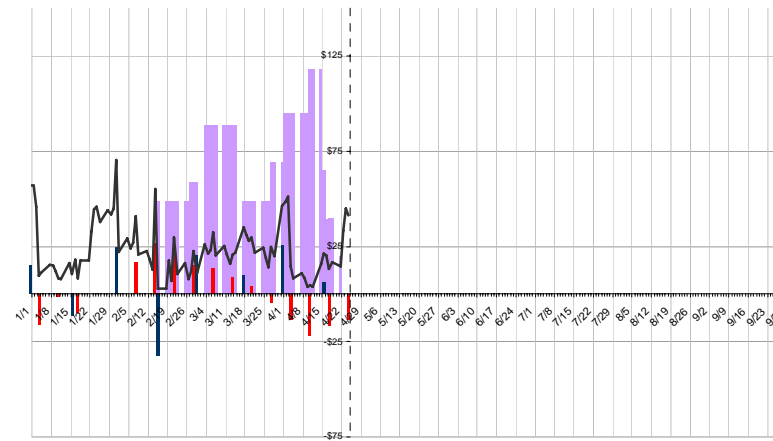
Near Term Financing Plan  
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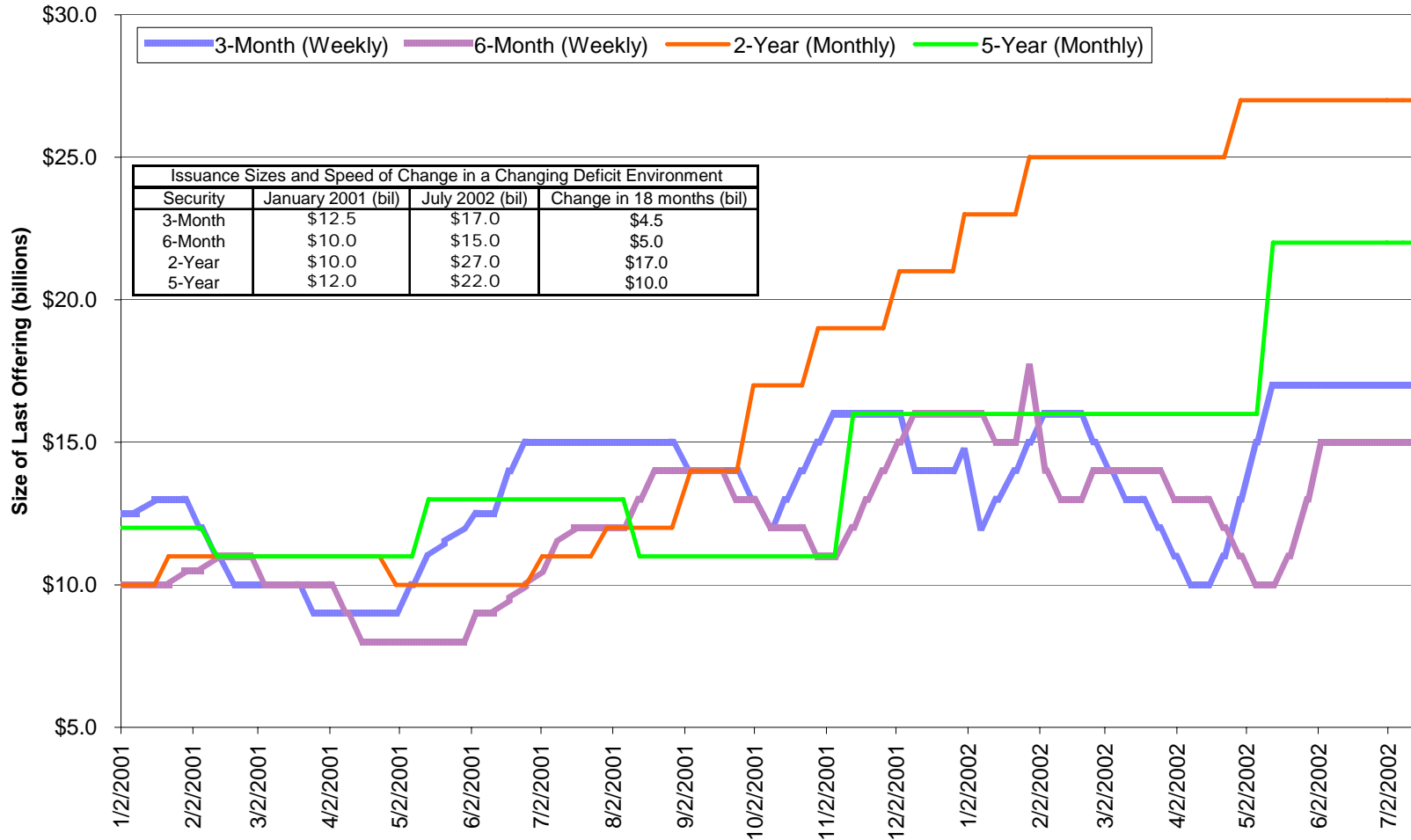
Near Term Financing Plan  
FY 2008

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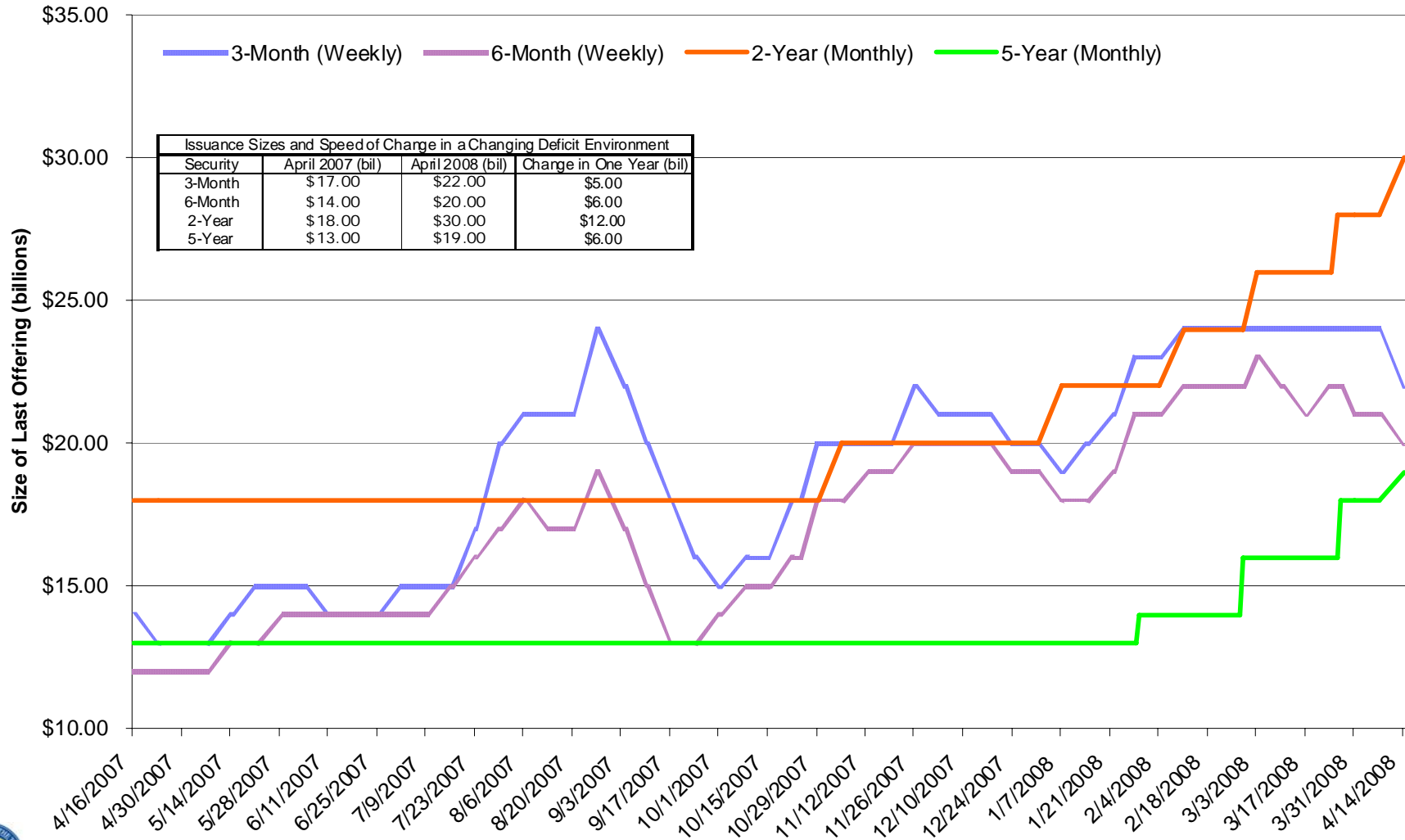
# In 2001 – 2002, Treasury financed an increasing deficit primarily through increases in bill and shorter-term coupon issuance

Changes in Issuance in Response to Increasing Deficits:  
2001 Revisited

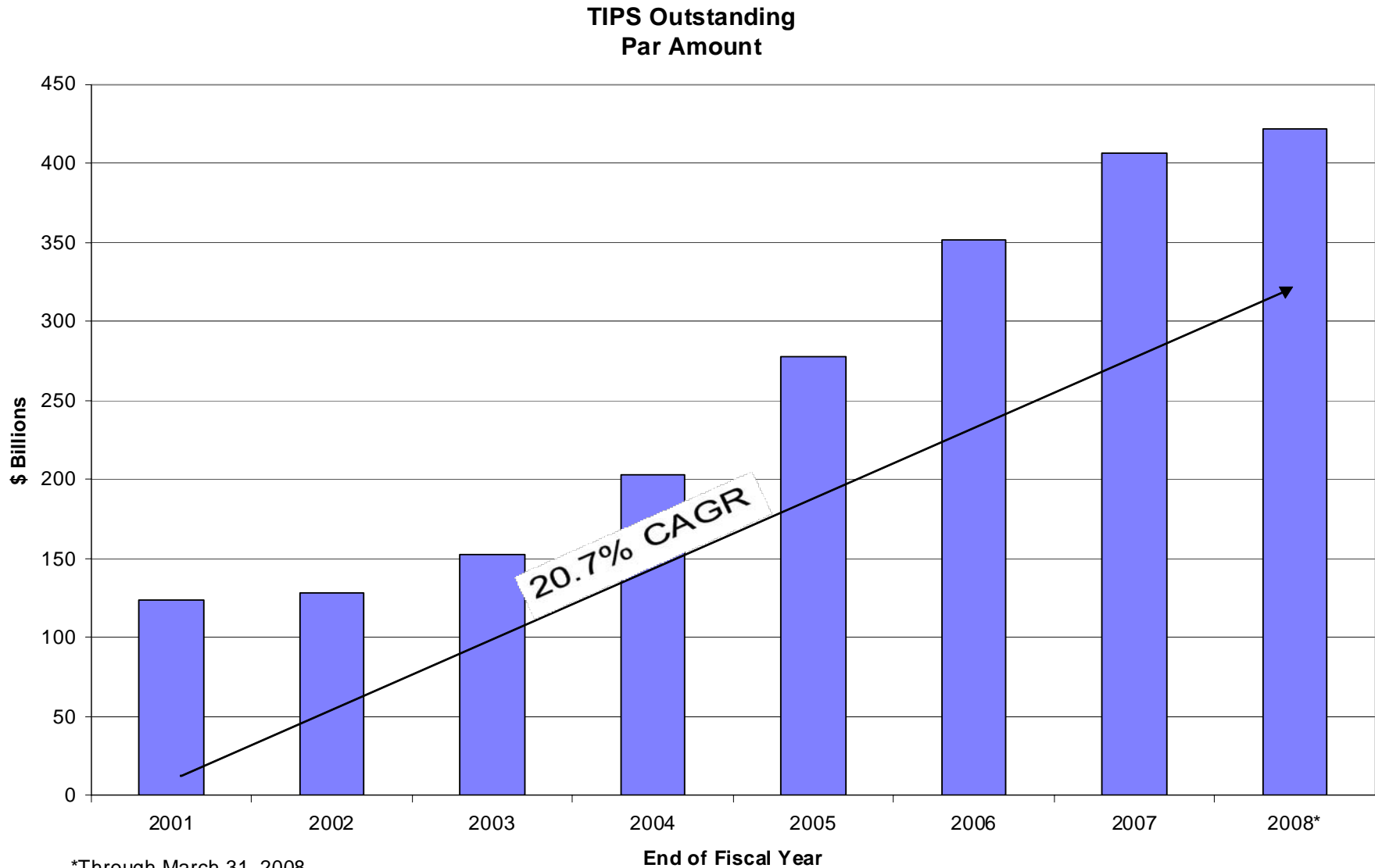


# Treasury has been financing this year's deficit in a similar manner

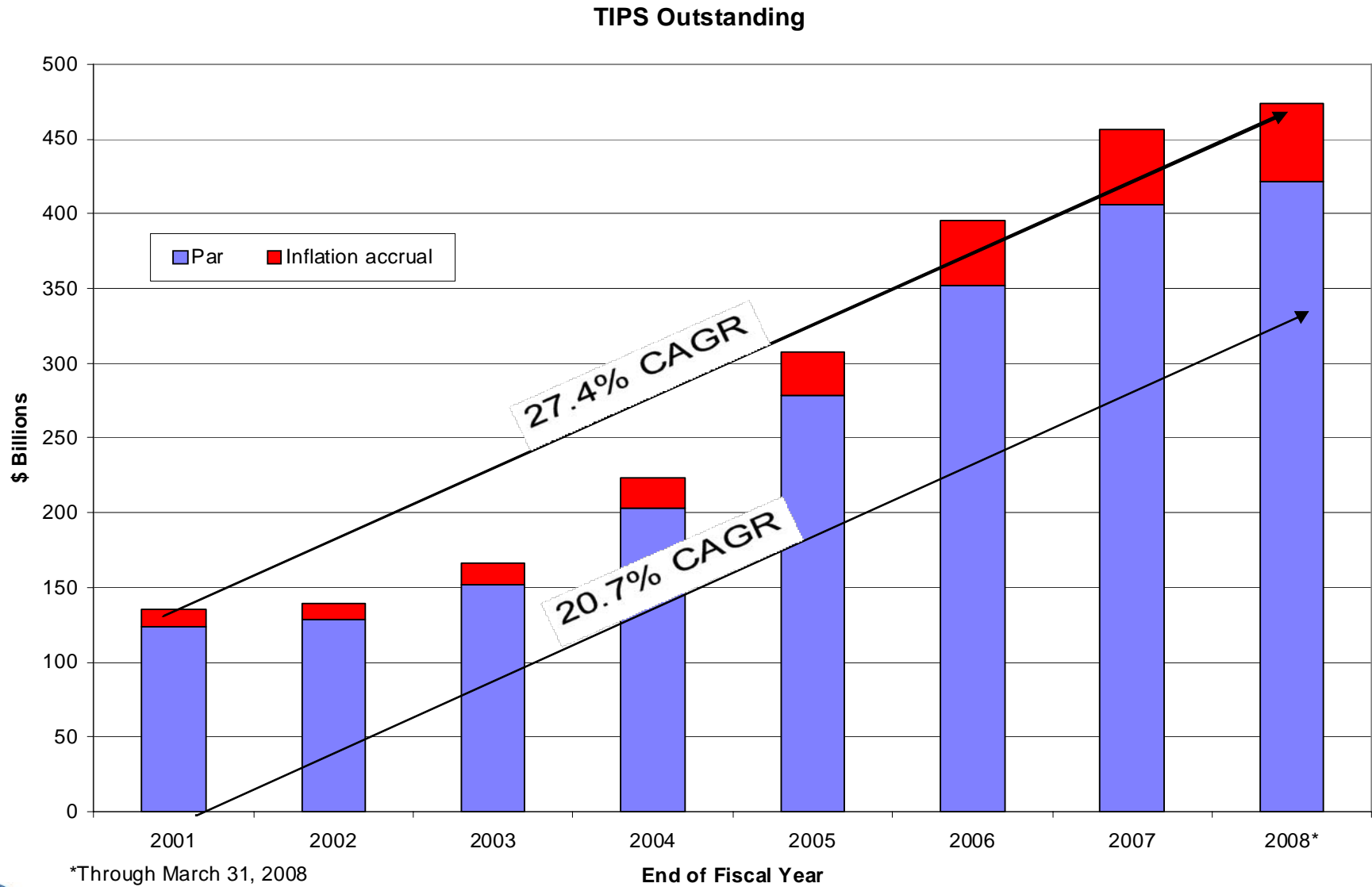
Changes in Issuance in Response to Increasing Deficits and a Stimulus Package:  
2007-2008



# Par TIPS outstanding have grown at a rapid clip

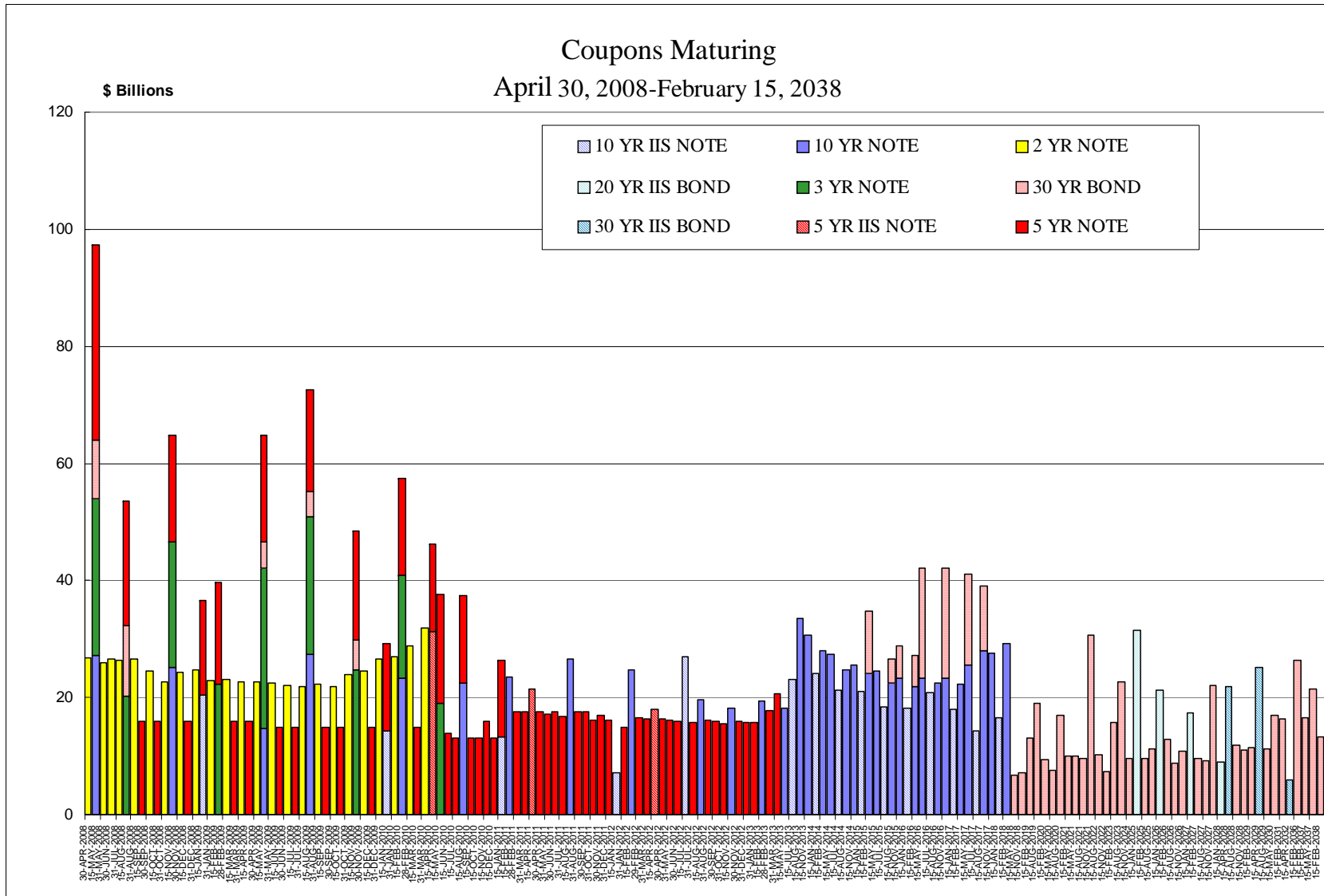


# Inflation accrual has grown at an even faster pace





# Maturing 3-year and 5-year notes create large outflows and cash management challenges



# Financing Considerations in FY 2008

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- ◆ Increased bills as a percent of the portfolio
- ◆ Increased nominal coupons from current low levels
- ◆ Issuing longer-dated cash management bills to bridge low points in cash balances during tax refund season and fiscal stimulus program
  
- ◆ But marketable borrowing needs remain high as a result of:
  - Lower net State and Local and Government Issuance
    - -\$10 b FY 08 through Q2 vs. \$43 b FY 07 through Q2
  - Redemptions by Federal Reserve
    - \$120 b impact FYTD 08
  - Sales by Federal Reserve
    - FYTD sales = \$114 b with impact of \$79 b in bills in FY 08
  - Enactment of fiscal stimulus program
    - \$168 b total size with rebates beginning in late April
  - Lower growth in revenue combined with higher growth in outlays
  
- ◆ Cash management and the overall debt profile, while manageable, remain a focus for debt managers and potentially call for additional tools.



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Given current and medium-term trends in the economic and financial market outlook, what are the TBAC's thoughts on Treasury's debt issuance? In particular, Treasury would like the Committee's views on the potential introduction of new securities, including the 52-week bill.



# Presentation to the Treasury Borrowing Advisory Committee

## Part 2



UNITED STATES  
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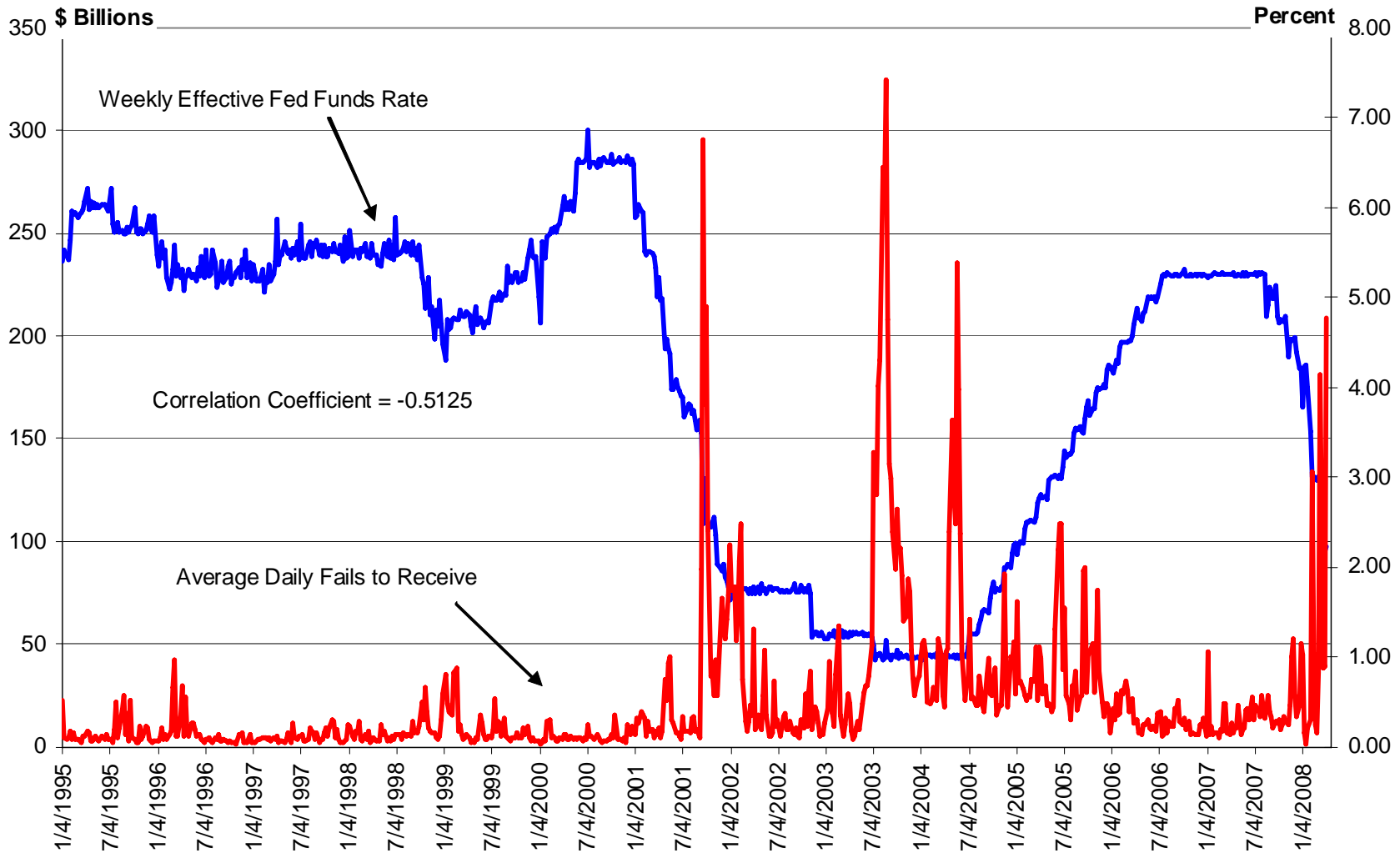
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Recent Actions by Market Participants to Address Fails in the Treasury  
Repurchase Market



As in 2001, fails have increased as the Fed Funds rate has declined rapidly

## Primary Dealer Treasury Security Settlement Fails Interest Rate Environment



Source: FRBNY FR2004 Settlement Fails Data & FRB H.15



# Since the February Refunding, Treasury has consulted with private market participants to prevent systemic fails

- ◆ At the February Quarterly Refunding, we discussed the potential environment in which lower interest rates raised the risk of chronic fails, a risk that we believe impairs liquidity and raises our cost of borrowing.
- ◆ In addition, we asked market participants to pursue the identification and implementation of market oriented solutions to help mitigate such a development.
- ◆ Private sector participants have responded with some actionable items to implement in the near term.
- ◆ The private sectors participants championing these efforts are the Securities Industry and Financial Markets Association (SIFMA) and the Treasury Market Practices Group (TMPG).



# Current SIFMA Responses

## ◆ **Prompt Delivery Trading Practice:**

- In 2004, SIFMA published a “prompt delivery” trading practice. A “prompt delivery” repo trade is a transaction in which the Seller represents that it can deliver a particular security within 15 minutes of entering into the transaction. If the transaction fails, the trade would be cancelled and the identity of the failing party would be disclosed to the non-failing party.
- Status: This trading practice is available, but is rarely used.

## ◆ **Negative Rate Repo Trading Practice:**

- In 2006, SIFMA published a Repo Trading Practice for negative repo rate trading. If a party enters into a negative rate repo transaction and fails to deliver securities, the rate on the transaction will be changed to the absolute value of the negative rate agreed upon. This provides incentive to deliver.
- SIFMA has formed a Task Force of operational professionals to ensure that all lessons learned from the March 2008 experience are incorporated into SIFMA practices.
- *Status:* Market participants entered into a number of negative repo rate transactions during the recent spike in settlement fails at the end of March 2008. SIFMA members believe that negative repo rate capability aids in addressing fails by allowing market participants to source securities at a market price that secures delivery.





# Additional SIFMA Initiatives

## ◆ **Fails Best Practices:**

- SIFMA is developing *Fails Best Practices*. These *Best Practices* are expected to recommend that when fails age beyond a few days, and in any event after five days, firms should implement risk mitigation procedures, including, but not limited to:
  - Margining of outstanding fails;
  - Limiting certain trading techniques;
  - Identifying pair-offs;
  - Facilitating or encouraging early cash-settlements; and
  - Attempting to source securities needed for delivery.
- Status: SIMFA expects to publish its *Best Practices* in a matter of weeks.

## ◆ **Buy-in Procedures for Government Securities: Cash Settlement.**

- SIFMA plans to publish revised *Buy-in Procedures* that will include a mandatory cash settlement feature which will enable dealers to closeout aged fails related to customer's securities. Prices to be determined by widely recognized sources.
- Status: The revised *Buy-in Procedures* have been approved by all relevant committees within SIFMA. SIFMA will submit an exemptive request to Treasury.



# Additional SIFMA Initiatives

- ◆ **Master Repurchase Agreement: Mini-closeout provision:**
  - SIFMA is developing a “mini-closeout” annex that can be used with the Master Repurchase Agreement (MRA). Allows fails to receive position to close out and settle only failing trade w/o closing out all transactions under the agreement.
  - Status: SIFMA’s Fails Task Force has endorsed this approach and will recommend to SIFMA’s Funding Division Executive Committee. Assuming approval by the Committee, SIFMA should be in a position to publish by mid-year.
  
- ◆ **SIFMA Treasury Fails Monitoring Committee:**
  - SIFMA will form a Treasury Fails Monitoring Committee with senior representation from the funding and cash markets including the buy-side.
  - The Committee’s function will be to assess the level of settlement fails on an ongoing basis and to alert the market, by public statement, when market-wide mitigation, remediation and the attention of management is warranted.
  - The Committee will be authorized to recommend particular practices that may address the specific circumstances causing an elevated level of settlement fails.
  - The Committee will develop metrics and objective standards that will aid in the Committee’s determination that a particular event warrants industry-wide attention.
  - Status: The Committee will be formally constituted prior to the publication of SIFMA’s Fails Best Practices.



# Treasury Market Practices Group Background

- ◆ The TMPG was formed in February 2007 to support the integrity and efficiency of the U.S. Treasury market through the promotion of best practices in Treasury cash, repo and related markets.
- ◆ Members include senior business and operations managers, legal and compliance professionals from securities dealers, banks and buy-side firms.
- ◆ The Federal Reserve Bank of New York sponsors the TMPG and provides legal and administrative support.
- ◆ In May 2007 the TMPG published “Treasury Market Best Practices” which outlines key principles for trading and operations. The document continues to be amended as market conditions and trading practices evolve.
- ◆ Ongoing work includes discussions around chronic fails remedies, collaboration with clearing entities on practices around general collateral financing, and fixed income prime brokerage best practices.



# Treasury Market Practices Group Initiatives

- ◆ Treasury Market Best Practices:
  - Expanded to recommend early management attention to large or uncharacteristic settlement fails in specific issues (February 2008).
  - Clarified best practice guidance for avoiding use of general collateral vehicles to finance “special” repo collateral (April 2008).
  - Considering whether changes to practice guidance are needed in light of recent negative rate and guaranteed delivery trading in the repo market.
  
- ◆ Increased coordination of settlement among custodians, asset managers, clearing corporations, etc:
  - Round-robin netting mechanism across clearing banks being developed.
  
- ◆ Broad support for all proposed SIFMA initiatives.
  - However, some differences remain in the timing and pricing of the cash settlement option of the Buy-in rule.
  - TMPG strongly encourages cash settlement for resolution of fails before Day 30.



# Issues for Consideration

- ◆ Buy-in procedures:
  - Timeframe of 5 business days vs. currently 30 days before acting.
  
- ◆ Negative rate repo trading:
  - Implementation and practices.
  
- ◆ Impose more demanding measures:
  - Capital charges as a result of fails to deliver.
  - Margining as a result of fails to deliver.
  
- ◆ Other potential responses?



# Charge to the Treasury Borrowing Advisory Committee

- ◆ At the February Refunding, we discussed the potential for an environment in which lower interest rates raised the potential risk of systemic fails, a risk that we believe impairs liquidity and raises our cost of borrowing.
- ◆ In addition, we asked market participants to pursue the identification and implementation of market oriented solutions to help mitigate such a development.
- ◆ What is the Committee's view on actions taken by market participants? What other steps would you suggest be undertaken? What type of timeline and benchmarks would be most effective?

