

Thomas R. Donovan
President and
Chief Executive Officer

October 7, 1999

Government Securities Regulations Staff
Bureau of the Public Debt
999 E Street NW, Room 315
Washington, DC 20239-0001

Gentlemen:

The Chicago Board of Trade is pleased to submit these comments on the Department of the Treasury's rule-making proposal regarding redemption of Treasury securities. 64 Fed. Reg. 42626 (August 5, 1999). The Chicago Board of Trade supports the concept of a Treasury security buy-back operation, which the Treasury is considering in light of declining government borrowing needs.

We favor the buy-back approach over other alternatives to reducing public debt because that approach will help ensure that new issue Treasury securities remain large enough and liquid enough to continue as a benchmark for dollar interest rates over the full maturity spectrum. One alternative, to issue fewer new securities, could have the effect of producing an increasing number of smaller sized, less liquid issues, which thus fail to become benchmark-pricing points. Another alternative, to reduce the number of issues, would produce fewer pricing points, thus again reducing the Treasury markets' effectiveness as a standard to which other fixed income markets could be related.

The Chicago Board of Trade's financial futures contracts have become an essential part of dollar fixed income activity worldwide due to their liquidity and the price transparency. They are widely used to hedge not only Treasury debt but also agency and corporate fixed income securities.

The Chicago Board of Trade's futures and options markets are based on rules that allow a number of Treasury securities, within a specified maturity range, to be physically delivered in satisfaction of these contracts. The price discovered in the futures market is usually based on the spot price of the security which satisfies the terms of the futures contract at the cheapest cost to the seller, since it is the seller, or short, who has the option of which of the deliverable securities to deliver in satisfaction of its obligation. This security is known as the "Cheapest to Deliver" or CTD. It is generally the case that the CTD security will be an off-the-run issue, which therefore gains status as the CTD security and a market develops for that security which is more liquid than that of its close neighbors in the yield curve.

The effectiveness of the futures market depends on the price of the Cheapest to Deliver security (and those close to being Cheapest to Deliver) moving in a predictable fashion relative to its neighbors in the yield curve. We are therefore concerned that redemption operations, which

disturb the pricing continuity of the yield curve, could have a damaging effect on the usefulness of the futures market and a corresponding negative effect on the liquidity and risk premiums in all dollar fixed income securities.

We recommend that when the Treasury is designing a redemption operation, it considers the features of the Treasury futures markets and acts to minimize the potentially disruptive effects of a buy-back on the CTD security and those securities which are close to becoming Cheapest to Deliver. We also recommend that the Treasury consider the implications of its redemption operations on the expiration of the March, June, September and December delivery cycles of the Chicago Board of Trade's Treasury futures markets and possibly refrain from or limit such operations in those months in order to minimize disruptions in the futures and options markets.

I trust these comments are helpful to you and we remain, as always, willing to discuss these matters with you at your request.

Sincerely,

A handwritten signature in cursive script, appearing to read "Thomas R. Donovan".

Thomas R. Donovan