

REPORT TO THE SECRETARY OF THE TREASURY
FROM THE
TREASURY ADVISORY COMMITTEE
OF THE
BOND MARKET ASSOCIATION

January 30, 2002

Dear Mr. Secretary:

Over the past three months...

The next question from the Treasury had to do with the calculation of the net long position (NLP) as part of the auction process and efforts by the Treasury to reduce the time between submission of auction bids and announcement of results. Currently, net long positions for Treasury auctions are calculated as of 12:30 p.m. for a 1:00 p.m. auction close, and reportable net long positions are submitted along with bids for calculation of the 35 percent award limit. Would it be feasible to have the net long position calculation computed at 1:00 p.m., but reported after the close of an auction? Effectively, bidding entities would be responsible for net long calculations relative to amounts bid, and auction awards would be based solely on amounts bid. Net long positions for purposes of the 35 percent rule would be determined after awards are made. If this approach were taken, the Treasury asked what sanctions the Committee would recommend if an entity were found to be in violation of the 35 percent rule.

Most Committee members felt that separating NLP reporting from actual auction bidding and moving the reporting point from 12:30 to 1:00 p.m., while somewhat more burdensome to the bidder, was manageable practically. It might create some unintended consequences including smaller bid to cover ratios and generally weaker auction results. In recent years the dealer community has improved its ability to calculate NLP quickly and accurately and because of this most Committee members felt that moving the NLP calculation from 12:30 to 1:00 could be accomplished easily. The self policing aspect of the 35 percent rule, however, was more troubling as it shifted the burden of staying within the 35 percent limit squarely from Treasury to the bidder. In the past, a bidder could submit multiple bids in excess of the 35% rule knowing Treasury would reduce the award to be conforming. Under the self policing method, however, the bidder would be in violation once the threshold bid was awarded in auction. To avoid this situation bidders would almost certainly place fewer auction bids leading to smaller bid/cover ratios and possibly to weaker auction results. The Committee felt strongly that any benefits to Treasury afforded by quicker turnaround time in these situations should be weighed against the potential for weaker auction results.

In response to the question of recommended sanctions if an entity were found to be in violation of the 35 percent rule, the strong majority of Committee members felt that current sanctions were appropriate if not onerous. Also, it was unclear whether the change in NLP reporting would lead to fewer or more violations of the 35 percent rule. Treasury could adjust sanctions in the future if material violations of the 35 percent rule increased.

Finally, the Committee felt that improving the electronic capabilities of the auction platform could both improve Treasury auction turnaround and increase investor participation in the auction. For instance, if a bidder were able to check all auction inputs electronically prior to submission, errors would be kept to a minimum while customer participation remained high and auction turnaround quick.

Finally, the Committee recommendation...

Respectfully submitted,

James R. Capra, Chairman

Timothy W. Jay, Vice Chairman