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THE BOND MARKET ASSOCIATION

June 28, 2002

VIA EMAIL AND FACSIMLE

The Honorable Brian C. Roseboro
Assistant Secretary for Financial Markets
United States Treasury Department
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220-0002

Dear Mr. Assistant Secretary:

The Bond Market Association ("we" or the "Association"[1]) appreciates the opportunity to comment on the proposal by the Treasury Department ("Treasury") set out in its May 1, 2002 quarterly refunding statement regarding potentially utilizing term repurchase transactions ("repos") to reduce the costs associated with short term fluctuations in its cash balances. The Association fully supports the use of term repo transactions by Treasury.

The Association believes that the use of term repo transactions will aid Treasury in reducing costs associated with its cash balances, thereby reducing borrowing costs overall. As Treasury is well aware, financial institutions frequently utilize repo transactions as a means of short-term cash investment because of the flexibility such transactions provide, their operation within a robust legal framework, and the historically low losses associated with such transactions. These positive attributes allow the Federal Reserve Bank of New York (FRBNY) to effectuate their open market operations in an efficient and stable manner.

The Association respectfully submits the following suggestions for the conduct of term repo operations by Treasury. We believe these suggestions will allow Treasury to best meet its goal of lowering borrowing costs by encouraging broad dealer participation.

Triparty Repo: The Association has previously advocated the continued use of triparty

[1] The Association represents securities firms and banks that underwrite, distribute and trade fixed income securities, both domestically and internationally. The Association's member firms are actively involved in the funding markets for such securities, including the repurchase and securities lending markets. This letter was drafted based on the input of members of the Association's Primary Dealers Committee and Funding Division Executive Committee. Further information regarding the Association and its members and activities can be obtained from our web site (www.bondmarkets.com).

repo in connection with the conduct of open market operations by the FRBNY.[2] Triparty repo provides a number of advantages for Treasury as a cash investor; as a recent governmental white paper noted, "From the cash investors' perspective, the triparty repo market provides a great deal of liquidity and safety for their cash holdings."[3] These advantages are due, in part, to the operational ease and flexibility triparty repo provides. From a cash investor's perspective, triparty repo offers the operational advantage of allowing the substitution of securities by the repo seller during the term of a repo transaction (based on a set of guidelines the cash investor provides), without imposing the operational burden on the cash investor of retrieving and exchanging the securities it has purchased (or "reversed in") for such substitute securities. Another advantage for Treasury, as cash investor, would be the likelihood that it would be able to get a higher repo rate through the use of a triparty repo facility. Further, the amount of resources that would need to be devoted to the creation of a triparty repo facility would presumably be minimal given the existing triparty facility utilized by the FRBNY for the conduct of its open market operations. The Association also believes that the institution of triparty repo should encourage greater participation among the dealer community in Treasury's term repo program, thereby providing greater liquidity to the repo markets.

Certainty: The Association believes that any potential market impact caused by the influx of funds by Treasury into the repo market could be significantly mitigated by the adoption of consistent and predictable practices in conducting its term repo program. Such practices should include conducting repo operations on regular and predictable intervals. Advance notice of any Treasury term repo operation (with a consistent interval between such notice and the effectuation of term repo operations) should also be instituted. While the Association realizes that excess cash balances may vary, the amount of funds invested by Treasury in such repo transactions should also be consistent to the extent possible in order to mitigate potential adverse market impact. Any potential adverse impact to the market could also be further mitigated by coordinating Treasury's repo operations with the open market operations of the FRBNY.

Types of Securities: It is our understanding that currently Treasury may be statutorily limited to utilizing Treasury securities in its repo operations. While Treasury securities are the most commonly utilized type of instrument in the repo markets, utilizing only such securities may not provide Treasury with the flexibility it desires as a cash investor. Specifically, by utilizing a broader range of securities in its repo operations, Treasury would have a wider range of repo rates available to them. This wider range of rates would provide Treasury with additional flexibility in tailoring their repo operations to meet their desired rates of return. In addition, offering a wider range of securities would encourage increased dealer participation, particularly given the need for dealers to finance a broad range of securities. For these reasons, the Association believes that the Treasury, to the

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[2] Specifically, please see the Association's comment letter, dated March 14, 2000, regarding the continuation of FRBNY's ability to engage in triparty repo, available at the following link: http://www.bondmarkets.com/regulatory/tripartycomment.shtml.

[3] *Interagency White Paper on Structural Change in the Settlement of Government Securities: Issues and Options,* Board of Governors of the Federal Reserve System and Securities and Exchange Commission, Appendix 2, p. 15.

extent possible, should utilize a broad range of securities in its term repo operations. Ideally, Treasury should accept the same security types as accepted by the FRBNY when conducting repo transactions for its open market operations.[4]

Timing: The majority of repo transactions are conducted earlier in the morning by dealers in order to ensure that they meet their financing needs. As such, the Association suggests that any Treasury term repo operations be conducted early in the day as an incentive for dealers to participate to the greatest extent possible. By providing funding to dealers earlier in the day, Treasury could also potentially help reduce intraday credit (i.e. "daylight overdraft") that would otherwise be extended by depository institutions to such dealers to meet their intraday financing needs.

Margin Rules: We believe the Treasury should institute clear and competitive margin requirements when effectuating repo transactions depending on the types of securities accepted by Treasury. By informing dealers of margin requirements in advance of Treasury's repo transactions, such dealers will be better prepared to participate in such transactions. Such transparency on the part of Treasury will encourage broader dealer participation.

The Association appreciates the opportunity to comment on Treasury's announcement regarding the potential use of term repo transactions. Please feel free to contact me at 212.440.9474 or ooztan@bondmarkets.com or Eric Foster at 212.440.9448 or efoster@bondmarkets.com with any questions.

Sincerely,

Omer Oztan
Vice President and
Assistant General Counsel
The Bond Market Association

cc: Tim Bitsberger, Deputy Assistant Secretary for Federal Finance, U.S. Department of the Treasury
Dino Kos, Executive Vice President, The Federal Reserve Bank of New York
Lori Santamorena, Executive Director, U.S. Department of the Treasury
Primary Dealers Committee
Funding Division Executive Committee
Funding Division Legal Advisory Committee
Selected Staff, The Bond Market Association

[4] In addition to Treasury debt, the FRBNY accepts "stripped" securities of U.S. Treasury and government agency debt; pass-through mortgage securities of the Government National Mortgage Association, Freddie Mac, Fannie Mae; and debt obligations of the Student Loan Marketing Association.