J.P.Morgan

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Department of the Treasury
Bureau of the Public Debt
Government Securities Regulations Staff
799 9th Street NW.
Washington, DC 20239-0001

RE: Docket No. BPD-2012-0002
Sale and issue of marketable book-entry Treasury bills, notes and bonds

To whom it may concern:

J.P. Morgan Securities LLC ("J.P. Morgan") is pleased to submit comments on the potential issuance of floating rate notes (FRNs) by Treasury.

Choice of index rate for the FRN

We would recommend indexing FRNs using Treasury general collateral repo rates rather than Treasury bills as bill-based floaters offer limited benefit over simply issuing short-term Treasury bills. In a hypothetical market stress scenario where perceived US credit risks increased sharply, FRNs tied to bill yields offer little diversification benefit. By contrast, repo rates are likely to be more stable in this circumstance, producing lower repricing risk for the Treasury. This has clearly been evident in recent years in Europe where peripheral bill yields have increased significantly more than repo rates as credit concerns escalated. For example, in the Fall of 2011, 6-month bill yields in Italy and Spain increased 300 bp; 6-month repo increased 35 bp.

An even better choice for indexing FRNs, in our view, is the Fed funds effective rate. This rate should be uncorrelated (or negatively correlated) to bill yields in a stressed credit scenario, creating term funding that insulates Treasury from credit-related rollover risk. In addition, a liquid derivatives market for Fed funds exists, which should make effective hedging possible and enhance liquidity in the product. Finally, investor demand for Fed funds linked floaters has been much greater than bill-based floaters. Within the Agency debt FRN market, 38% of outstandings are linked to the Fed funds effective rate, 58% to Libor, and only 0.8% to the T-bill rate. Virtually all corporate floaters outstanding are linked to Libor.

Conversion of the stop out T-bill auction rate

Treasury requested comments on whether the conversion of the High Rate should be done on an ACT/360, ACT/365 or some other basis if T-bills are used as a reference rate. Virtually all Agency and corporate FRNs are ACT/360 and we would recommend Treasury maintains consistency with those markets.

Choice of T-bill maturity

If T-bill yields are used as a reference rate, the appropriate bill maturity appears to be the 13-week bill based on already existing FRN markets. For instance, all Agency FRNs linked to T-bill rates use the 13-week bill rate as reference.

Using a broader tri-party Treasury GC rate versus a narrower subset, such as DTCC's Treasury GCF index, as the Index Rate

Of all the GC repo measures, GCF Treasury trades have the greatest transparency. That said, using a GCF index does have some limitations. Since the GCF repo market is an inter-dealer market, pricing can be impacted by dealers' ability and willingness to participate. This market is also not geographically diversified, as evidenced by operational dislocations during Superstorm Sandy. Treasury's decision to average daily resets to calculate quarterly interest payments in an FRN would serve to mitigate such risk.

Such limitations notwithstanding, the DTCC Treasury GCF index is the broadest and the most widely followed measure of repo rates; a broader measure, if desired, would need to be created.

Issue of forward trades settling beyond one business day having unknown accrued interest
This is not likely to be an issue for the market. Agency FRNs are routinely settled on a forward basis with unknown accrued interest.

Quarterly versus semiannual, or other, frequency of interest payments
Quarterly interest payments would be appropriate. The composition of the Agency debt FRN market is supportive of this view, with 57% of the market having a quarterly payment schedule and 42% having a monthly payment schedule. For corporates, more than 98% of outstanding FRNs pay quarterly.

Appropriate length of the lock out period for interest payments
In our view, dealers and most investors would likely not have a problem with a shorter lockout period of one business day (compared to current convention of 5 business days) since many corporate FRNs have short lock out periods.

Need for a minimum interest rate of zero percent
The minimum interest rate should be floored at zero in our view.

Need for appropriate minimum level on the spread added to the reference rate
The minimum interest rate of zero should largely suffice in our view. Specifying a minimum spread, below which the spread's interpretation is changed to a discount margin, adds complexity to the FRN product, and could result in securities being auctioned above par. All this should be unnecessary under most interest rate environments.

Only when term funding rates for Treasury fall to zero or below will a minimum threshold become necessary. For instance, in a hypothetical market environment where term Treasury

yields are zero or negative and volatility is low, and the FRN's design does not include a minimum spread, an investor could bid arbitrarily large negative spreads for a 2Y FRN and still receive the same set of cash flows (i.e., a 2Y zero coupon Treasury) for par. In such a case, the spread simply loses its meaning. Moreover, if term rates fall below zero, and FRNs are issued at par with coupon cash flows bounded at zero, the result would be an economic transfer from Treasury to investors.

However, the challenges that arise from such an interest rate environment are not unique to FRNs, but for Treasury issuance more broadly. For example, the existing zero bound on yields at auction already implies that when Treasury term rates fall below zero, nominal auction rules will need to be revisited to allow negative rate bidding. If and when this occurs, bill yields – and GC repo rates – will likely fall to negative levels, and Treasury will need to redesign auction procedures to avoid giving away a windfall to investors. FRNs could be included as part of such a broader redesign – for instance, if and when negative yields become a possibility in nominal T-bill and coupon Treasury auctions, the minimum floor of zero on FRN interest rates could be eliminated, allowing for negative interest rate accruals. Operationally, negative rate accruals could potentially be handled by reducing the principal repayable at maturity. Alternatively, FRNs could be auctioned at a pre-determined above-par price (say, 102) with par being repayable at maturity, and with a continuing zero floor on the minimum interest rate.

Therefore, we do not recommend imposing a minimum spread threshold below which the spread's interpretation changes to a discount margin; we view the added complexity as unnecessarily specific to FRNs, while the problem it is designed to address is a broader one.

Issuance details: new note issued quarterly with 2 potential reopening in the subsequent months, and mid-month versus end of month settle

With many of the initial Treasury FRN buyers likely to be money market funds, or similar liquidity-focused investors, we think FRN demand would be helped by avoiding calendar related low-liquidity days such as month-ends. Although there may be a marketing advantage to auctioning and settling FRNs with similar tenor fixed-rate bonds, many liquidity focused investors hold extra cash over month- and quarter-ends to deal with potential redemptions. We think this calendar-related liquidity raising would detract from FRN auction demand at month-end. We suspect investor demand would generally be better mid-month, although corporate tax-days and MBS settlements may sometimes reduce mid-month market liquidity. Historically, the GSEs have favored mid-month settlement. Of the Agency FRNs outstanding at the end of November 2012, 22% had their first settlement date between the 11th and 15th calendar day of the month, while 10% had their first settlement date after the 25th calendar day of the month. In corporate FRNs, settlement dates are more evenly distributed; 18% of outstandings had their first settlement date after the 25th calendar day of the month.

Changing rules to delay Treasury notification of accrued interest to no later than the day before the issue date (from the day after the auction)

We do not view this as a problem.

Using a Discount Margin for auction reopenings or any issues with the proposed pricing formulas found in Appendix B

We do not see an issue with this. See also our response to the discussion on the minimum spread.

Issuing a new security every month versus having fewer issues with larger sizes (via reopenings)

We recommend issuing a new security every quarter with subsequent reopenings so that the larger sizes result in better liquidity.

Maturity of FRN

Initially, we believe 1- to 2-year FRNs would be best since these maturities would most appeal to money market funds and securities lenders. As the product grows, we believe Treasury could issue 3- to 5-year maturities.

Appropriate issuance size

Having larger size at initial auction and smaller re-openings would be preferable since the larger initial size would be result in better liquidity in the first month after auction. Issuing $6bn in the initial auction followed by 2 re-openings of $3bn each could be one alternative.

STRIPS eligibility

We agree with the proposal to not make FRNs strippable, at least for now. Stripping FRNs with a floor on the minimum interest rate could result in coupon STRIPS that are expected to pay zero cash flows, whose values would reflect mainly an option component. This could diminish its appeal for some investors, and result in stripping activity being driven by option market demand dynamics.

J.P. Morgan appreciates the opportunity to comment on the potential for Treasury floating rate notes. If you have any questions about these comments, please contact the undersigned at troy.l.rohrbaugh@jpmorgan.com or (212) 834-7440.

Sincerely,

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