

January 10, 2013

Mr. Matthew Rutherford
Assistant Secretary for Financial Markets
Department of the Treasury
Bureau of the Public Debt
Government Securities Regulations Staff
799 9th Street NW.
Washington, DC 20239-001

RE: Docket No. BPD-2012-0002

Public Input on the design details, terms and conditions, and other features of Treasury Floating Rate Notes

Dear Mr. Rutherford,

BMO Capital Markets, Corp. (“BMOCM”) is pleased to submit comments on the design details, terms and conditions, and other features of Treasury Floating Rate Notes.

1. *Index Rate:*

We believe that the 13-week Treasury bill rate should provide lower borrowing costs for the government versus a Treasury general collateral repurchase agreement rate. First, the pricing spread on the Treasury floater should reflect the basis between the indices to result in the same price, so the fact that the overnight general collateral rate has been higher than the 13-week Treasury bill rate on average over the past 10 years should not matter. However, the 13-week Treasury bill rate has been less volatile than the overnight general collateral rate over the past 10 years. The standard deviation of the 13-week Treasury bill rate over the past 10 years has averaged .06 on a weekly basis versus .09 for the overnight general collateral rate. A funding vehicle that is less volatile should result in a lower funding cost.

An argument for choosing a GC rate as the index rather than the 13-week Treasury bill would be to ensure that the floating rate product is indexed off of an underlying rate that is independent of Treasury influence. Given that the Treasury uses bill issuance to assist with their cash management needs, using a bill as the underlying instrument may undermine the Treasury’s goals. Market participants also may perceive this as a potential conflict of interest. Should the Treasury choose to index the floating rate note off of the GC rate, we recommend the use of an index such as DTCC’s Treasury GCF index. This index rate is published daily and is therefore a more transparent rate than one representing broader tri-party repo transactions. DTCC also has daily historical data for the Treasury GCF Repo Index dating back to 2005.

We believe that the conversion to the High Rate should be done on an ACT/360 basis, in order to maintain consistency with the 13-week bill. This also seems to be short floater asset convention.

2. *Reset Frequency:*

We do not believe that unknown accrued interest on forward trades settling beyond one business day will present any problems for market participants. Secondary market floating rate securities currently trade on a forward settlement basis, where the accrued interest is not known until the reset date.

3. *Frequency of Interest Payments:*

We believe that the quarterly payment structure is preferable, as this is consistent with existing floating rate securities.

4. *Lock Out Periods:*

Market convention for floating rate securities is a two day look-back. While we believe that a one business day lock out period would be achievable, increasing the lock out period to a two day period would be beneficial from an operations standpoint.

5. *Minimum Interest Rate:*

We agree with the Treasury that a minimum interest rate of zero percent should be implemented. We do not believe that any alternative structure would be preferable.

6. *Minimum Spread:*

We agree that a minimum spread of zero is preferable and will be better received by the investment community. Setting the minimum at zero rather than a nominal minimum spread allows the Treasury the lowest borrowing cost while simultaneously ensuring that the FRN is always issued equal to or at a premium to the index.

7. *Auction Technique:*

We agree with the Treasury that bids should be accepted in increments of one tenth of a basis point, to maintain consistency with the two year note auction. This tighter calculation increment will result in a more precise clearing rate, which at times may reduce the borrowing cost to the Treasury.

We do not see any problems which would arise in the FRN auction from following the rules which are currently applied to other Treasury securities.

8. *Auction Frequency and Settlement:*

In order to ensure that the new product is readily absorbed into the marketplace, we believe that a mid-month settlement is preferable. We expect that there will be significant interest in the Treasury's FRN program from the money management community, which prefers securities settled mid-month in order to avoid cash management issues and ensure balance sheet availability. We also believe that the Treasury may risk poaching some of their demand if they were to issue all of their two year note issuance in the same auction cycle.

In addition, the Treasury market is a transparent and liquid market. We therefore do not believe that the Treasury FRN needs to be auctioned in the same cycle as the two year note in order to achieve market transparency.

We do not believe that changing Section 356.24(c) of the Uniform Offering Circular in order to accommodate for FRNs will cause any operational issues for participants.

9. *Reopenings:*

We have no objection to the use of a discount margin or to the Treasury's proposed pricing formulas in the case of reopened auction issuance.

We agree that the reopening of issues would provide additional liquidity of FRN securities, which would help to ensure that the new product is readily absorbed into the marketplace. However, from an operations standpoint, reopening auctions may be more cumbersome and may detract from the transparency of the market. We believe that these operational issues could present an operational challenge to the acceptance of the new security. Provided that the size of the new issue is large enough to ensure liquidity in the secondary market, we believe that the Treasury should issue a new floating rate security each month.

10. *Maturities:*

We agree that the initial phase of the program should consist of a two year maturity. Looking to future phases of the program, we believe that the greatest client demand for floating rate securities will be three years and under. Confirmation of this can be found in the market for agency floating rate paper: one hundred percent of outstanding floating rate paper issued by Fannie Mae, Freddie Mac, and FHLB is two year or under paper, while Farm Credit has only five to ten percent outstanding in paper dated three to five years. As demand for the product is concentrated in three year or under paper, we believe that the Treasury would be best served to issue mainly in this sector, with small size in the five year sector if the Treasury wishes to extend.

11. *Offering Amounts:*

We believe that there will be substantial demand for Treasury issued floating rate product at the time that the Treasury will be introducing issuance. Due to increased bank liquidity regulations, investors will look to products that do not require holding of derivatives against such assets. The agencies, which have traditionally been a large supplier of floaters, are making substantial cuts to their programs, and investors will look to replace those holdings. Investors will also be looking to floaters in order to minimize their interest rate risk once we begin to enter a rising interest rate environment. For these reasons we believe that any issuance provided by the Treasury will be readily absorbed into the market, provided that investors are comfortable with all of the operational aspects of the new product.

If the Treasury chooses to issue a new floating rate security each month, we suggest that the Treasury will be able to issue size of \$35bn, or an amount in line with the prevailing two year security auction. Similarly, should the Treasury choose to issue a new security only once a quarter, we suggest

that the original issue size should be \$35bn, with two reopenings of at least \$20bn each. In this case, we believe it would be preferable for the initial auction size to be larger than reopening offering amounts in order to maintain consistency with current auction convention.

12. *Stripping:*

We do not believe that there would be any interest for a strip product at this time.

Please feel free to contact us if you have any questions or require additional information.

Sincerely,



Scott J. Graham
Head of Government Bond Trading