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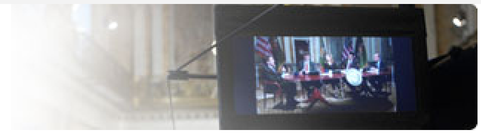

Minutes of the Meeting of the Treasury Borrowing Advisory Committee Of the Securities Industry and Financial Markets Association

8/1/2012

The Committee convened in closed session at the Hay Adams Hotel at 9:30 a.m. All Committee members were present except for Richard Axilrod and Ian Banwell. Under Secretary for Domestic Finance Mary Miller, Acting Assistant Secretary for Financial Markets Matthew S. Rutherford, Senior Policy Advisor James Clark, and Director of the Office of Debt Management Colin Kim welcomed the Committee, including the newest Committee member Jon Kinol. Other members of Treasury staff present were Fred Pietrangeli, Jennifer Imler, Amar Reganti, Jamie Franco, Ian Samuels, Tim Bowler, Matt Carey, Joshua Louria, Jake Liebschutz, and Tom Katzenbach. Federal Reserve Bank of New York members Josh Frost and Sean Savage were also present.

Senior Policy Advisor James Clark began with a brief review of the fiscal situation, noting that the economy posted a 1.5 percent growth rate in the second calendar quarter of 2012, the twelfth straight quarter of growth since the recession ended in June 2009.

Clark then discussed the recent trends in receipts. Clark noted that FY12 receipts were expected to be about $2.4 trillion, approximately 6 percent higher than receipts in FY11.

Within the various receipts categories, Clark noted that withheld taxes for 2Q CY12 totaled $426 billion despite a 2 percent reduction in payroll taxes. Corporate taxes rose by $9 billion relative to the comparable quarter in 2011. This reflected a decline in accelerated depreciation rates and the expiration of carry back refund provisions.

Clark then showed a chart with the ten largest outlays in the fiscal year to date. The chart showed that social security expenditures were $32 billion higher compared to the same period in FY11, reflecting a 3.6% cost of living adjustment. Also, Treasury expenditures rose $18 billion relative to a comparable period in 2011. Clark noted that the increase in Treasury expenditures reflected subsidy adjustments for TARP and HERA and that interest payments were actually $11 billion lower than in 2011. Meanwhile, labor expenditures declined by $20 billion in FY12 relative to the comparable period in FY11, reflecting lower unemployment claims and a reduction in unemployment benefits from 99 weeks to 73 weeks.

Clark noted that net issuance of State and Local Government Series (SLGS) securities increased by $9.2 billion, reflecting the increased issuance of debt by state and local governments to take advantage of record low yields.

Next, Clark noted that primary dealer deficit estimates for FY12 were in line with CBO's latest deficit estimate of about $1.17 trillion, but about $50 billion below the Administration's FY13 Mid-Session Review (MSR) released in late July.

Director Kim then provided a brief overview of historical and projected net marketable borrowing. Assuming that future issuance remains constant, Director Kim noted that Treasury was underfunded by more than $225 billion in FY2013 and even more significantly underfunded in the years beyond FY2016.

Next, Director Kim reviewed several debt metrics. As of June 30, 2012, the average maturity of the portfolio was approximately 64.2 months. In the chart presentation showing the projections for Treasury's weighted average maturity, Kim adjusted future note and bond issuance on a pro-rata basis to match projected financing needs. The simulation showed that the average maturity continues to extend well above the 3 decade average of 58.1 months. By 2016 it could reach the upper end of the historical range.

He emphasized that the average maturity projections and the associated underlying assumptions for future issuance were hypothetical and not meant to convey future debt management policy or an average maturity target. He also reiterated that Treasury will remain flexible in the conduct of debt management policy.

Director Kim then quickly reviewed the demand characteristics within the primary market for Treasury securities over Q3 FY12. Director Kim noted that bid-to-cover ratios remained high relative to historical levels across all securities.

Director Kim concluded with a brief review of investor trends in auctions, noting that primary dealers increased their portion of bill and short coupon awards in Q3 FY12 while investment funds increased their awards of long coupons and TIPS over the same period.

A Committee member asked about the status of Treasury allowing negative rate bidding in bill auctions. Under Secretary Miller noted that Treasury is in the process of building the operational capabilities to allow for negative rate bidding in Treasury bill auctions, should this become necessary in the future. She also noted that no decision had been made to implement negative rate bidding at this time.

The Committee then moved to consider the second charge which dealt with the Federal Reserve's Maturity Extension Program (MEP) and its medium-term impact on Treasury's borrowing needs.

The presenting member noted that the original MEP lowered Treasury's borrowing capacity through 2016 by $400 billion and that the extension of MEP lowered it by an additional $267 billion.

The presenter noted that prior to the MEP announcement Treasury was projected to be overfunded for the next several years and in a position to reduce coupon offerings. However, after considering the impact of MEP, Treasury was projected to be underfunded through FY2016. For FY2012, Treasury funded the gap left by the initial round of MEP by maintaining coupon auction sizes and increasing the size of bill auctions. The presenter noted that for FY2013 through FY2016 Treasury would need to raise an additional $425 billion, assuming constant coupon auction sizes.

Next, the presenting member reviewed various scenarios by which Treasury could finance this gap, including financing with bills, coupon securities or floating rate notes. According to the presenter, depending on how Treasury finances the effect of MEP, the average maturity at the end of FY2016 could range from 67.5 month to 70.2 months.

Committee members then debated the best way to fund the short-term effect of MEP. Some members noted that increasing coupon issuance to fund the MEP shortfall would be consistent with the Committee's long standing recommendation to extend the weighted average maturity. Another member noted that bills would offer more flexibility because issuance sizes could be quickly increased or decreased, given the uncertainty around the fiscal cliff. Many members also noted the virtues of floating rate notes (FRNs). The members briefly discussed possible indexes for a Treasury FRN. There was interest in further exploring the Treasury GCF index, especially given the recent launch of the NYSE Liffe's listed GCF futures.

In the end, the Committee recommended funding the MEP-related gap with a combination of securities in a manner that preserves flexibility, diversifies funding sources, and continues to assist Treasury with the long-standing goal of increasing the weighted average maturity of the portfolio.

The Committee next turned to the question about how the government should finance direct lending, particularly student loans.

The presenting member first gave a brief history of student loan programs within the United States and touched upon descriptions of a variety of student loan programs. The member noted the pro-cyclicality of the student loan program, stating that student loan origination is likely related to the overall economy: if the economy decelerated, the speed of repayment on the loans would slow and more loans could be underwritten as individuals sought educational alternatives. This would occur at a time when Treasury would likely already be increasing issuance because of lower tax revenues and increased expenditure. However, as an offset, it should be noted that Treasury's borrowing costs could be lower in this scenario. The opposite effect could occur in an improving economy.

The member then discussed how student loans would impact Treasury's financing needs. Specifically, the member noted that there is likely to be an increased divergence between the deficit and Treasury's net financing need, given that there is now an asset to offset Treasury's liability.

The member then moved to discuss liability management and the issuance options available to Treasury that would support its mandate of reducing cost for the taxpayer. A variety of securities with accompanying pricing were listed. However, no specific recommendations were made. The member noted that greater transparency and data availability would allow for better modeling of cash flow variations; such analysis would be highly useful in assisting Treasury in determining how to fund such assets.

The meeting adjourned at 12:00 p.m.

The Committee reconvened at the Department of the Treasury at 5:00 p.m. All Committee members were present except for Richard Axilrod and Ian Banwell. The Chairman presented the Committee report to Deputy Secretary Wolin.

A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The Committee then reviewed the financing for the remainder of the July through September quarter (see attached).

The meeting adjourned at 6:00 p.m.

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Matthew Rutherford
Acting Assistant Secretary for Federal Finance
United States Department of the Treasury
July 31, 2012

Certified by:

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Matthew E. Zames, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
July 31, 2012

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Ashok Varadhan, Vice Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
July 31, 2012

Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – July 31, 2012

Fiscal Outlook
Taking into consideration Treasury's short, intermediate, and long-term financing requirements, as well as uncertainties about the economy and revenue outlook for the next few quarters, what changes to Treasury's coupon auctions do you recommend at this time, if any?

Impact of the Maturity Extension Program (MEP) on Treasury Finance
The Federal Reserve's Maturity Extension Program (MEP) has a medium-term impact on Treasury's borrowing needs. Please discuss how Treasury should address the financing shortfall created by MEP.

Financing Government Direct Lending
US Government issuance of direct loans has grown in recent years, particularly following the discontinuation of the guaranteed student loan program in 2010. What approaches should Treasury consider to minimize cost and optimize composition of the net new issuance that finances these assets going forward?

Financing this Quarter
We would like the Committee's advice on the following:

- The composition of Treasury notes and bonds to refund approximately $54.2 billion of privately-held notes maturing on August 15, 2012.
- The composition of Treasury marketable financing for the remainder of the July - September quarter, including cash management bills.

The composition of Treasury marketable financing for the October - December quarter, including cash management bills

TBAC Recommended Financing Table Q3 2012 and TBAC Recommended Financing Table Q4 2012