Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association October 30

October 31, 2018

The Committee convened in a closed session at the Hay-Adams Hotel at 9:00 a.m. All members, with the exception of Terrence Belton and Irene Tse, were present. Counselor to the Secretary Craig Phillips, Deputy Assistant Secretary for Federal Finance Brian Smith, Director of the Office of Debt Management Fred Pietrangeli, and Deputy Director of the Office of Debt Management Nick Steele welcomed the Committee. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Dave Chung, Tom Katzenbach, Devin O'Malley, Peter Phelan, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Lorie Logan, Nathaniel Wuerffel, Susan McLaughlin and Jake Schurmeier were also present.

Director Pietrangeli opened the meeting with an overview of the fiscal situation. Pietrangeli noted that FY2018 receipts were little changed year-over-year, rising just $14 billion. Non-withheld income and SECA taxes increased by $89 billion in FY2018, with the bulk of the increase occurring in April for CY2017 tax liabilities. Withheld income and FICA taxes rose by $23 billion, reflecting growth in both employment and wages. The gains were largely offset by a $76 billion decrease in corporate taxes, a 22 percent decline year-over-year. Corporate refunds also increased by $17 billion, a 39 percent increase year-over-year. Outlays totaled $4,108 billion over the same timeframe, an increase of five percent. Notable increases include $83 billion for Treasury related to interest on the public debt and a decline in receipts from Government-Sponsored Enterprises, $43 billion for increased enrollment and increased average benefit payments for Social Security, $41 billion for Health and Human Services due mostly to increases in Medicare, $36 billion due to increased Defense expenditures, and $18 billion for the Department of Homeland Security including increased payments for disaster relief.

Pietrangeli then turned to the near-term fiscal outlook, highlighting the most recent annual marketable borrowing estimates from the Office of Management and Budget, the Congressional Budget Office, and the primary dealers. All of the forecasts indicate a substantial funding gap in

FY2019 and subsequent years. Estimates regarding the timing of the end of SOMA Treasury portfolio redemptions is a key factor for primary dealers in forecasting borrowing amounts over the next three fiscal years. Turning to the prior quarter, Pietrangeli noted that in the July- to-September quarter, Treasury was able to address its significant funding needs, some of which was seasonal, through coupon auction increases announced in FY2018, as well as through net bill issuance of $82 billion. Looking ahead, the recently announced privately-held net marketable borrowing estimates of $425 billion for the October-to-December 2018 quarter and assuming an end-of-December cash balance of $410 billion, indicates net bill issuance of $116 billion assuming coupon sizes are held constant at August 2018 levels.

Next, Deputy Assistant Secretary Smith discussed the introduction of the new benchmark two-month bill. Smith noted that the auctions have been well received, with above average bid-to-cover ratios and stop-out rates in line with the yield curve.

Smith then summarized for the Committee the feedback from primary dealers in response to the recent quarterly refunding agenda discussion topics. On the topic of the Treasury Market Practices Group's (TMPG) White Paper on Clearing and Settlement, primary dealers generally agreed that the paper represented a thorough study of the topic and outlined a number of potential risks to the clearing and settlement process. Primary dealers focused on the volume of bilaterally cleared trading and intraday credit extension. Primary dealers suggested a number of policy recommendations for consideration, including expanding the use of central clearing, evaluating margins for bilateral trading, changing settlement timing, and increasing transparency regarding counterparties' clearing and settlement practices. Smith strongly endorsed the TMPG's work in this area and reiterated Treasury's commitment to supporting the robustness of clearing and settlement practices in the Treasury market.

Next, Smith summarized primary dealer feedback on the likely timing for the end of SOMA's balance sheet normalization and the composition of Treasury securities in the SOMA portfolio after normalization. Primary dealers provided a range of estimates for the most likely timing of the end of normalization, while relaying that their estimates were subject to a substantial amount of uncertainty. Once normalization ends, dealers expect the Federal Reserve will reinvest SOMA mortgage-backed security principal payments into Treasury securities along with the purchases of Treasury securities necessary to offset currency growth. Finally, many dealers indicated the Federal Reserve would likely pursue a roughly market-weighted portfolio composition after normalization, though the balance of risks was seen as skewed toward a shorter-duration portfolio. The Committee agreed that the outlook is uncertain and that Treasury should continue to monitor expectations for the end of SOMA portfolio normalization closely to assess the potential impact to the financing outlook.

Counselor Phillips then provided an update on Treasury's efforts regarding secondary market transaction data for Treasury securities collected through FINRA's TRACE. Phillips noted that the initial outreach phase with market participants had concluded and that Treasury was continuing to analyze the data to inform the policy decision-making process. Phillips noted that no decision has been made at this time and that Treasury plans to provide further details on this topic at the 4th Annual Conference on the Evolving Structure of the U.S. Treasury Market on December 3rd.

Next, the Committee turned to a presentation updating the TBAC debt issuance model to incorporate Treasury Inflation-Protected Securities (TIPS). The presenting member emphasized that the modeling results do not constitute a specific recommendation but rather provide an approach to analyze cost and risk trade-offs under various assumptions. According to the model, debt service costs for TIPS are typically lower but more volatile than that of equivalent maturity nominal securities. Furthermore, similar to the nominal model, five-year TIPS offer a cost advantage over longer-maturity issuance. The Committee followed the presentation with a discussion, generally agreeing that the conclusions were in line with their previous recommendations to gradually increase TIPS issuance to maintain the current proportion of TIPS relative to nominals, focusing increases in the 5-year maturity.

Deputy Director Steele then discussed primary dealers' expectations for issuance over the next quarter. Dealers broadly expected an increase in coupons similar to those announced in August, with a risk towards slightly smaller increases. Most dealers also expected Treasury to announce the new October 5-year TIPS maturity and remove the October 30-year TIPS reopening in the 2019 issuance calendar, while maintaining the overall share of TIPS issuance near its recent levels through gradual increases in auction sizes. The Committee concurred that increased TIPS issuance would be well received and estimated that a range of $20 to $30 billion in additional TIPS issuance in 2019 would maintain TIPS share of outstanding debt around current levels. The Committee also agreed that additional issuance should be focused at the 5-year maturity, facilitated by the introduction of a new October 5-year TIPS in line with option 1 presented in the July primary dealer agenda.

Following the TIPS discussion, the Committee turned to a discussion around financing for the upcoming quarter. The Committee agreed that the same pattern of coupon issuance as announced by Treasury at the August quarterly refunding would be appropriate. However, the Committee noted that the pace of future coupon increases is expected to slow notably over the remainder of FY2019.

The Committee then turned to a charge regarding the transition away from LIBOR and toward the Secured Overnight Financing Rate (SOFR). The presenting member described the significant progress already made and the steps to follow in the market's transition. The presenting member then outlined the risks and benefits of transitioning to SOFR-linked instruments, focusing on the asset-liability implications of the two rates.

Next, the Chair presented the Committee report to Secretary Mnuchin. A brief discussion followed the Chair's presentation, but did not raise significant questions regarding the report's content.

The Committee adjourned at 12:30 p.m. for lunch.

The Committee reconvened at 1:30 p.m. to continue the discussion about the transition from LIBOR to SOFR. Members noted that transition plans were already underway at most firms but that the timeline could still prove challenging. The Committee noted the importance that the burgeoning market for SOFR linked issuance plays in the transition and concluded that Treasury should further study this market.

The Committee adjourned at 2:30 p.m.

The Committee reconvened at the Department of the Treasury at 4:30 p.m. All Committee members, with the exception of Terrence Belton, Irene Tse, Mike Lillard and Christine Hurtsellers, were present. The Chair presented the Committee report to senior Treasury officials. A brief discussion followed the Chair's presentation, but did not raise significant questions regarding the report's content.

The Committee adjourned at 5:20 p.m.

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Brian Smith
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury
October 30, 2018

Certified by:

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Elizabeth Hammack, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
October 30, 2018

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Daniel Dufresne, Vice Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
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Treasury Borrowing Advisory Committee Quarterly Meeting

Committee Charge – October 30, 2018

FISCAL OUTLOOK

Taking into consideration Treasury's short, intermediate, and long-term financing requirements, as well as the variability in financing needs from quarter to quarter, what changes to Treasury's coupon auctions do you recommend at this time, if any?

AN UPDATE ON THE TBAC ISSUANCE MODEL – INCORPORATING TIPS

Please provide an update on efforts the Committee is making with regard to the development of issuance models, including any updated analysis or results and any revisions to or extensions of the modeling work that was presented in October 2017, particularly the incorporation of TIPS into the model. Comment on the degree to which the updated modeling efforts can be used by Treasury as one input to help to inform potential its decisions regarding nominal coupon and TIPS issuance.

TRANSITION FROM LIBOR TOWARD THE SECURED OVERNIGHT FINANCING RATE (SOFR)

Please comment on developments regarding the transition away from LIBOR and toward the Secured Overnight Financing Rate (SOFR). How should market participants evaluate the risks of continued use of financial instruments linked to LIBOR? Summarize developments in SOFR derivative markets, the introduction of SOFR-linked issuance, and your expectations 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 $54.3 billion of privately-held notes maturing on November 15, 2018.
• The composition of Treasury marketable financing for the remainder of the October-December 2018 quarter, including cash management bills.

• The composition of Treasury marketable financing for the January-March 2019 quarter, including cash management bills.