LCH The Markets' Partner

Via electronic submission

July 6, 2020

Mr. Brian Smith
Deputy Assistant Secretary for Federal Finance
U.S. Department of the Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220

Re: Development and Potential Issuance of Treasury Floating Rate Notes Indexed to the Secured Overnight Financing Rate; Docket No. TREAS-DO-2020-0007

Dear Deputy Assistant Secretary Smith:

LCH Group ("LCH") welcomes the opportunity to respond to this notice and request for information from the U.S. Department of the Treasury ("Treasury") regarding the Development and Potential Issuance of Treasury Floating Rate Notes Indexed to the Secured Overnight Financing Rate ("Request for Information").[1]

LCH is an international, multi-asset class group of clearing houses, or central counterparties ("CCPs"), that manage risk of many diverse portfolios of cleared derivatives.[2] As part of our collateral management function, LCH invests a significant amount of its U.S. dollar ("USD") cash margin received in U.S. Treasury securities. LCH also evaluates U.S. Treasury securities as eligible collateral for swaps counterparties to post as margin against their cleared positions.

Given our role in the cleared Interest Rate Swap ("IRS") market, LCH remains fully committed to supporting the transition to SOFR.[3] The creation and issuance of Treasury Floating Rate Notes ("FRNs") indexed to the Secured Overnight Financing Rate ("SOFR") would benefit the broader SOFR transition by encouraging liquidity in the new rate and building a strong relative value for SOFR.

---

[1] U.S. Department of the Treasury, Development and Potential Issuance of Treasury Floating Rate Notes Indexed to the Secured Overnight Financing Rate, Docket No. TREAS-DO-2020-0007, 85 FR 31282, *available at* https://www.govinfo.gov/content/pkg/FR-2020-05-22/pdf/2020-11160.pdf .

[2] LCH Group is a leading multi-asset class and multi-national group of clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. LCH Group clears a broad range of asset classes including securities, exchange-traded derivatives, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling denominated bonds and repos.

[3] LCH Group is a member of the Alternative Reference Rates Committee ("ARRC"), *available at* https://www.newyorkfed.org/arrc/about#members.

LCH provides the following specific comments to the Treasury's Request for Information:

1. Market Demand

1.1. Which types of investors would be the primary buyers of Treasury SOFR-indexed FRNs? Would Treasury SOFR-indexed FRNs attract new investor types or additional demand from existing Treasury investors? Assuming the possibility of a 1-year or 2-year maturity, how would the tenor of a Treasury SOFR-indexed FRN affect demand?

Demand for SOFR-indexed FRNs would likely originate from similar investors that currently buy T-bill FRNs due to the low investment rate risk associated with FRNs. SOFR-indexed FRNs would potentially attract new types of investors, depending on the relative value and hedging opportunities across the market. SOFR-index FRNs with a one-year maturity would likely attract greater demand than a two-year maturity due to various constraints in the market.

2. Pricing and Liquidity

2.2. How would you expect a Treasury SOFR-indexed security to price relative to a comparable maturity 13-week T-bill FRN security? How would this pricing vary across the economic cycle and interest rate environments? Please provide pricing estimates.

The price of a SOFR-indexed FRN relative to a comparable T-bill FRN will be dependent on the yield curve between one and three months. Once investor demand has stabilized and hedging tools are utilized, SOFR-index FRNs should trade at an appropriate relative value to a comparable T-bill FRN.

2.5. How liquid would Treasury SOFR-indexed FRNs be in secondary markets? Please compare the expected liquidity of Treasury SOFR-indexed FRNs to Treasury bills, the existing 13- week T-bill FRN, and off-the-run short dated coupons.

The liquidity of SOFR-indexed FRNs in secondary markets would improve as the SOFR market matures. Hedging would assist increasing liquidity in the SOFR market.

3. Security Structure

3.2. Some previously gathered feedback has suggested a 1-year final maturity for original issuance of a Treasury SOFR-indexed FRN. Is this maturity or another maturity preferable for a Treasury SOFR-indexed FRN? Please elaborate.

We support issuance of SOFR-indexed FRNs with either a one- or two-year maturity.

3.3. Is a quarterly issuance frequency with two reopenings appropriate for a Treasury SOFR indexed FRN, similar to the existing 13- week T-bill FRN? What factors should Treasury consider in making this decision?

Yes, a quarterly issuance frequency with two re-openings is appropriate for a SOFR-indexed FRN. Other issuance schedules will be an important consideration in determining which day in the quarter SOFR FRNs should be issued.

3.4. When during the month should Treasury auction SOFR-indexed FRNs? When should auctions settle?

The Treasury should ensure the auction of SOFR-indexed FRNs does not clash with T-bill auctions. Auctions settlements should occur mid-month.

3.6. What coupon frequency should be used for a Treasury SOFR-indexed FRN? Note that the existing 13-week T-bill FRN pays coupons quarterly. Would a semi-annual, or other coupon frequency be preferred? When during the month should coupon and principal payments be made?

SOFR-indexed FRNs should have a quarterly coupon, with payments made mid-month, in line with auction settlements.

3.7. Should the index rate for a Treasury SOFR-indexed FRN reset daily, weekly, or at some other frequency?

The index rate for a SOFR-indexed FRN should initially reset on a daily frequency, potentially adjusting over time based on market developments.

4. Existing 13-Week T-Bill FRN

4.2. Should Treasury issue FRNs indexed to both indices, or should Treasury consolidate FRN issuance on a single index?

We recommend Treasury issue FRNs indexed to both indices.

5. Market Transition

5.2. To what extent would Treasury's issuance of SOFR-indexed FRNs advance the overall market transition away from U.S. dollar LIBOR? How would different market segments (e.g., FRNs, derivatives, business loans, consumer products) be affected by Treasury's decision to issue SOFR indexed FRNs? What effect would Treasury's issuance of SOFR-indexed FRNs have on the overall market transition away from LIBOR beyond that caused by current issuance of SOFR indexed FRNs by other issuers? Please provide specific details of the cause and effect relationships you expect.

The issuance of SOFR-indexed FRNs is a material step in advancing the market transition towards SOFR. As the SOFR market continues to mature, market segments will adapt to a decision by the Treasury to issue SOFR indexed FRNs. Given the important global role of the U.S. Treasury market, the issuance of SOFR-indexed FRNs would be an important driver relative to other SOFR indexed FRNs.

* * *

We would be pleased to discuss any of our comments in more detail.

Sincerely,

Jonathan Jachym
Head of Government Relations and Regulatory Strategy, Americas
London Stock Exchange Group

CC: Fred Pietrangeli, Director, Office of Debt Management, Office of the Assistant Secretary for Financial Markets