



Internal Auditors Society

Internal Audit Guidelines U.S. Treasury Auctions

March 2012

The Audit Guidelines (the "guidelines") are intended to provide members of the Internal Auditors Society ("IAS"), an affiliate of the Securities Industry and Financial Markets Association ("SIFMA") with information for the purpose of developing or improving their approach towards auditing certain functions or products typically conducted by a registered broker-dealer. These guidelines do not represent a comprehensive list of all work steps or procedures that can be followed during the course of an audit and do not purport to be the official position or approach of any one group or organization, including IAS or any of its divisions or affiliates. Neither IAS, nor any of its divisions or affiliates, assumes any liability for errors or omissions resulting from the execution of any work steps within these guidelines or any other procedures derived from the reader's interpretation of such guidelines. In using these guidelines, member firms should consider the nature and context of their business and related risks to their organization and tailor the work steps accordingly. Internal auditors should always utilize professional judgment in determining appropriate work steps when executing an audit.



Internal Auditors Society

TABLE OF CONTENTS

I. Introduction and Background.....	1
II. Audit Guidelines.....	11
III. Glossary	24
Appendix A	27
Appendix B.....	31
Appendix C	32
Helpful Links	34



Internal Auditors Society

I. Introduction and Background

I. INTRODUCTION AND BACKGROUND

A. Overview

The United States Department of the Treasury (“Treasury”) conducts public auctions of U.S. Treasury marketable securities. The auctions are used to finance the Government's operations and refund maturing debt through the sale of Treasury Bills, Notes, Bonds, and Treasury Inflation-Protected Securities (“TIPS”). Each security is of varying maturity (a listing of products by maturity can be found on page 7).

Treasury works closely with its large auction participants (Primary Dealers and 8 to 10 other large auction participants) in many ways. Primary Dealers are required to bid in every auction. One of the most critical processes of this relationship is the announcing, auctioning and issuing of its marketable debt securities. The auction process lowers the cost of financing the national debt by offering a competitive bidding environment. The Treasury conducts its auctions to raise the necessary funds to operate the Government and to refund maturing debt through its Treasury Automated Auction Processing System (“TAAPS”), which employs a single-price “Dutch” style auction, where all successful bidders receive the same rate or yield at the highest accepted bid.

The auction is first announced through the Treasury via email press releases as part of their free subscription service, and press releases via major news services, usually several days beforehand, but can occur with less notice. The offering announcement contains details such as auction date, issue date, maturity date, offering amount, CUSIP, and NLP threshold. (Please see Exhibit B for an example for further details.) Bids are then submitted and after the auction close, TAAPS calculates and processes the auction results. Securities are awarded to successful bidders, notifications of the auction results are delivered to the financial press, submitters and clearing banks, and auction awards are ultimately delivered on issue day to successful auction bidders through their clearing entities.

Treasury has adopted a series of rules¹ and provided best practices that define terms and conditions, set bidding and award limits, and call for timely and accurate reporting, as well as many other rules.

Treasury established its Compliance Program to ensure that all submitters and bidders are in compliance with Treasury's auction rules. Each firm, in turn, has established its own compliance program to ensure compliance with Treasury auction rules. The Treasury auction rules are outlined in the Department of the Treasury's Uniform Offering Circular at www.treasurydirect.gov. Some highlights discussed are:

- What authority does the Treasury have to sell and issue securities?
- To which securities does this circular apply?
- What definitions does one need to know to understand this part?
- What is the role of the Federal Reserve Banks in this process?
- What is the purpose of an auction announcement?
- What are the different types of bids and do they have specific requirements or restrictions?

¹ See 31 CFR 356.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

A memo from the Federal Reserve Bank of New York, dated March 25, 2011, provides background and guidelines for the Federal Reserve's Primary Dealer Compliance Program. Below are key points from the memo. The entire memo can be found in Appendix C.

- The New York Fed Reserve Bank expects a primary dealer to maintain a robust compliance program, including procedures to identify and mitigate legal, regulatory, financial, and reputational risks.
- The New York Fed Reserve Bank may limit access to any or all of the primary dealer facilities or operations, and may suspend or terminate a primary dealer if it appears, in the New York Fed's judgment, to have an inadequate or weak control environment." Further, the Policy gives the New York Fed discretion to limit access to facilities or suspend or terminate the primary dealer relationship "if a primary dealer becomes the subject of, or involved with, regulatory or legal proceedings that, in the judgment of the New York Fed, unfavorably impacts the primary dealer relationship."
- At the end of the second calendar quarter in 2011, and semiannually thereafter, primary dealers will submit a disclosure to the New York Fed. The disclosure will state whether, in the preceding six-month period, the legal entity which is the primary dealer ("Firm") or its employees (a) became subject to, or reached a resolution, including settlement, regarding material litigation involving business lines or activities directly related to the primary dealer relationship, (b) received notice of a regulatory enforcement action or proceeding involving the primary dealer, or (c) experienced a Significant Compliance Matter.
- Primary dealers will also be required to file, not later than thirty calendar days after the end of calendar year 2011, and annually thereafter, a certification by the Firm's principal business contact with the New York Fed stating that, at all times during the relevant period, the Firm had in place policies and procedures reasonably designed to promote adherence to the Treasury Market Best Practices Guidelines and that the Firm has completed appropriate testing to confirm compliance with those Guidelines.
- In some cases, the New York Fed may undertake a review of the business relationship with an existing primary dealer. It is intended that this enhanced review process will be reserved for exceptional circumstances where there is an apparent risk, in the sole discretion of the New York Fed that continuing the primary dealer relationship would present heightened credit, reputational, or other risk to the New York Fed. The New York Fed will determine what form of enhanced review is appropriate in any particular case based on the facts presented.

B. Auction Rules

1. Net Long Position ("NLP")

One of the requirements of the Treasury auction rules is the timely and accurate reporting of a firm's NLP, which is used to limit the amount that will be awarded to any one bidder in an auction ("the 35 percent rule"). This rule ensures that awards in auctions are widely and equitably distributed to successful auction participants. This goal of broad distribution is intended to encourage participation by a significant number of competitive bidders in each auction. Broad participation keeps borrowing costs to a minimum, helps ensure that Treasury auctions are fair and competitive, and makes it less likely that ownership of Treasury securities will become overly concentrated.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

A bidder in an auction must report its NLP if, in the security being auctioned, the bidder's NLP plus its bids in the auction meet or exceed a certain dollar amount threshold as stated in the security's offering announcement. The NLP reporting threshold is typically 35 percent of the offering amount, but Treasury may state a different threshold in the offering announcement.² In addition, if the sum of a bidder's bids equals or exceeds the NLP reporting threshold, but the bidder has no position or has a net short position, it must report an NLP of zero. A bidder must determine its NLP as of one-half hour prior to the deadline for receipt of competitive bids. If a bidder meets or exceeds the reporting threshold as of the NLP determination time in the auction offering announcement, the bidder must report its NLP prior to the competitive bidding deadline. In addition, a primary dealer accepting a customer bid must inform the customer of their reporting obligation if they exceed bidding of \$100 million.

Overseas affiliates that are closed at the time of the calculation and whose positions/holdings are on separate trading platforms should submit their position at the end of the business day prior to the auction date. NLP documents (faxes and emails) from affiliates should be retained with the NLP calculation worksheet, including faxes and e-mails.

2. Competitive and Noncompetitive Bidding

There are two types of bids; competitive and noncompetitive. A bidder may not bid both noncompetitively and competitively in the same Treasury securities auction. Competitive bids require desired rate/yield and a dollar amount, while noncompetitive bids only require a dollar amount, and are limited to \$5 million for each separate bidder.

3. Award Process

At the close of an auction, Treasury accepts all noncompetitive bids that comply with the auction rules and then accepts competitive bids in ascending order in terms of their rate or yield until the quantity of accepted bids reaches the offering amount. All successful bidders will receive the same rate or yield at the highest accepted bid.

Below is a schedule of Auctions by Product Type. Any changes to schedule would be available at: http://www.treasurydirect.gov/instit/auctfund/work/auctime/auctime_securitiestable.htm

SECURITY	CUSIP ROOT	AUCTION FREQUENCY	ISSUE/ SETTLEMENT DAY	NLP REPORTING LIMIT	ELIGIBLE FOR STRIPS	STANDARD SECURITY DESCRIPTION FORMAT
Bills	912795					BILL MM/DD/YY
CMBs		Vary	Vary	35% of Offering Amt	No	

² See 31 CFR 356.13 for a detailed description of how to calculate and report a firm's NLP. See especially the components of the NLP calculation specified in §356.13(2)(c).

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

SECURITY	CUSIP ROOT	AUCTION FREQUENCY	ISSUE/ SETTLEMENT DAY	NLP REPORTING LIMIT	ELIGIBLE FOR STRIPS	STANDARD SECURITY DESCRIPTION FORMAT
4-Week		Weekly (usually Tuesdays)	Thursday	35% of Offering Amt	No	
13-Week		Weekly (usually Mondays)	Thursday	35% of Offering Amt	No	
26-Week		Weekly (usually Mondays)	Thursday	35% of Offering Amt	No	
52-Week		Every 4 weeks (usually Tuesdays)	Thursday	35% of Offering Amt	No	
Notes	912828					II I/I NOTE AA YY or II I/I NOTE A YY
2-Year		Every Month	End of month	35% of Offering Amt	Yes	
3-Year		Every Month	15th of month	35% of Offering Amt	Yes	
5-Year		Every Month	End of month	35% of Offering Amt	Yes	
7-Year		Every Month	End of month	35% of Offering Amt	Yes	
10-Year		Feb, May, Aug, Nov (Jan, Mar, Apr, Jun, Jul, Sep, Oct, Dec)	15th of month	35% of Offering Amt	Yes	
(Reopening)						
TIPS						
5-Year	912828	Apr	Last business day of month	35% of Offering Amt	Yes	NN N/N TRIN AAYYNN N/N TRIN AYY
(Reopening)		(Aug, Dec**)				
10-Year	912828	Jan and Jul (Mar, May**, Sep, Nov)	Last business day of month	35% of Offering Amt	Yes	NN N/N TRIN AAYYNN N/N TRIN AYY
(Reopening)						
20-Year	912810	Last auctioned 07/27/09	N/A	N/A	Yes	NN TRIB YY

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

SECURITY	CUSIP ROOT	AUCTION FREQUENCY	ISSUE/ SETTLEMENT DAY	NLP REPORTING LIMIT	ELIGIBLE FOR STRIPS	STANDARD SECURITY DESCRIPTION FORMAT
30-Year	912810	Feb (Jun, Oct)	Last business day of month	35% of Offering Amt	Yes	NN TRIB YY
(Reopening)						
Bonds	912810					II I/I BOND YY/MM or II I/I BOND CC-YY or II I/I BOND YY
20-Year		Last auctioned 01/08/86	N/A	N/A	No*	
30-Year		Feb, May, Aug, Nov (Jan, Mar, Apr, Jun, Jul, Sep, Oct, and Dec)	15th of month	35% of Offering Amt	Yes****	
(Reopening)						
STRIPS						
Noncallable Corpus (notes & bonds)	912820 912803	N/A	N/A	N/A	N/A	II I/I TPRN A YY or II I/I TPRN YY
Callable Corpus (bonds)	912800	N/A	N/A	N/A	N/A	II I/I TCAL C-YY
Interest Payment (notes & bonds)	912833 912834	N/A	N/A	N/A	N/A	TINT MM/DD/YY
Interest Payment (TIPS)	912833 912834	N/A	N/A	N/A	N/A	TIIN MM/DD/YY
Bearer Corpora Conversions (BECCS)	Program Ended November 15, 2006					
Tradable Callable Corpus	912800	N/A	N/A	N/A	N/A	XXX/X BCAL XX-XX
Nontradable Callable Corpus	912803	N/A	N/A	N/A	N/A	XX X/X NTCP XX-XX
Nontradable Callable Coupon	912815	N/A	N/A	N/A	N/A	NTCC XXX XX/XX/XX

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

SECURITY	CUSIP ROOT	AUCTION FREQUENCY	ISSUE/ SETTLEMENT DAY	NLP REPORTING LIMIT	ELIGIBLE FOR STRIPS	STANDARD SECURITY DESCRIPTION FORMAT
Coupons Under Book-Entry (CUBE)	912815	N/A	N/A	N/A	N/A	CUBE MM/DD/YY
All securities (Bills, Notes, Bonds, & TIPS) use the Single Price Auction method in determining the price for securities.						
All securities (Bills, Notes, Bonds, & TIPS) require minimum bids of \$100 in increments of \$100.						
All securities (Bills, Notes, Bonds, & TIPS) are auctioned using 3 decimal place bidding for competitive bids.						
If the normal issue or maturity day falls on a holiday or weekend, the securities will be issued or settled on the following business day.						
*20-Year bonds issued after 10/30/84 are eligible for the STRIPS program.						
**Beginning in 2011.						
***30-Year bonds issued before 11/15/84 are not eligible for the STRIPS program.						

4. NLP Requirements §31 CFR 356.13(a) – (d)

One of the most important reporting requirements for the auctions is in regard to the NLPs. All Primary dealers bidding in Treasury Auction must comply with NLP Requirements. The auction rule (31 CFR 356.13(c)) states that the NLP is comprised of:

- Holdings of the same CUSIP as the security being auctioned
- Holdings of STRIPS principal components of the security being auctioned
- Positions in the security being auctioned in:
 - When-issued trading (including when-issued trading positions of the STRIPS principal components)
 - Futures contracts requiring delivery of the specific security being auctioned
 - Forward contracts requiring delivery of the specific security being auctioned or of the STRIPS principal component of that security

NLP is *not* comprised of:

- Futures contracts for which the security being auctioned is one of several securities that may be delivered
- Futures contracts that are cash-settled
- Repurchase Agreements or other financing types of auction bids

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

The diagram below can be helpful to understand the requirement.

If . . .	And if . . .	Then . . .
(i) the total of your bids and the firm's net long position in the security equals or exceeds the reporting threshold		you must report your net long position (which does not include your bids).
(ii) the total of your bids in the auction equals or exceeds the reporting threshold.	you have no position or a net short position	you must report a zero.
(iii) the total of your bids and the firm's net long position in the security is less than the reporting threshold		you may either report nothing (leave the field blank) or report the firm's net long position.

C. Audit Objectives

The main objectives of a Treasury Auction audit are:

- To evaluate the adequacy of Treasury Auction policies and procedures.
- To determine that the auction bids are properly authorized, monitored, and recorded.
- To determine if the firm is operating in compliance with auction rules issued by the Department of the Treasury's Uniform Offering Circular, as well as Treasury Auction "Best Practices."

D. Audit Scope

The scope of the audit will include examination of the following activities and practices:

- Written Procedures and Documentation (up to date)
- Written Processes and Contingency Procedures, the Firm's Readiness to Participate in Treasury Auctions During a Wide Range of Contingencies, and Adequacy of Contingency Arrangements at the Alternate Site
- Trading and Sales adherence to auction rules and best practices
- Adherence to auction rules and best practices by support functions (e.g., Trade support, Operations, Compliance/Legal)
- Information Technology
- NLP Reporting from all entities that comprise the separate bidder

E. Audit Risks

Failure to manage inherent product and process risks can result in significant regulatory, legal, reputational, and financial losses to a firm, summarized as follows:

- Written Policies and Procedures
 - Treasury Auction policies and procedures are not in compliance with current regulations.
 - Treasury Auction policies, procedures and best practices are not adhered to.
- Trading and Sales
 - The firm is not operationally prepared to participate in the Auction.
 - Auction bids are not accurately booked or unauthorized resulting in improper activity and violations of U.S. Treasury Auction requirements.
 - Treasury traders are not properly supervised, which may result in improper business activities and violations of U.S. Treasury Auction requirements.
 - Customers are not notified of their reporting requirements for bid submissions in excess of \$100mm and awarded bids in excess of the competitive and noncompetitive award and bidding limits causing reputational harm, as well as potential regulatory fines and/or penalties.
 - The U.S. Treasury Trading Desk has not prepared and/or tested their contingency procedures as required by the U.S. Treasury, consequently, resulting in the failure to regularly and timely participate in Treasury auctions, costly business interruptions and /or loss of data in the event of a disaster or system failure.
- Trade Support
 - The calculation of NLP does not include data from all the firm affiliates.
 - Firm affiliates as required by the single bidder status, and / or the calculation methodologies are inconsistent causing the NLP calculation to be misstated and not properly reported to the Fed based upon the Treasury's NLP Reporting requirements. (Current threshold 35% of the Treasury offering amount).
 - U.S. Treasury auction bids are not recorded, recorded inaccurately, or lost during the transference of information between front office applications and downstream systems, resulting in misstated Firm records and violations of the Treasury's NLP threshold, thereby exposing the firm to potential regulatory fines, disciplinary action and/or reputational risk.
 - Auction file documentation is incomplete or not maintained for the required record retention period thereby violating regulatory requirements, exposing the firm to potential regulatory fines, legal proceedings, and/or disciplinary action.
- Information Technology
 - User access to the TAAPS terminal and TAAPS tokens/keys are not periodically reviewed / verified to evaluate access rights and functionality which may lead to unauthorized trading activity and compromised data and system integrity.
 - Failure to participate timely in User Access Surveys conducted by the Federal Reserve Bank of New York.
 - TAAPS tokens/keys are not properly safeguarded or destroyed (or returned to the Federal Reserve Bank of New York) when access rights are terminated.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

- TAAPS tokens/keys are not properly safeguarded, secured, and readily accessible at the Alternate (Primary Contingency) Site.
- Compliance and Legal
 - Compliance has no effective means of monitoring U.S. Treasury auction activity and accordingly cannot verify the Firm's compliance with regulatory reporting requirements thereby exposing the Firm to potential regulatory fines and/or disciplinary action.
 - The firm is not submitting required agreements and the semiannual and annual certifications causing the Firm to violate its agreement with the Treasury and Fed and thereby exposing the firm to potential regulatory fines and/or disciplinary action.
 - Fixed Income personnel locally, as well as in overseas affiliates, are not properly trained on the Firm's contractual and regulatory requirements as a Primary Dealer of U.S. Treasury Securities and could therefore cause the Firm to unknowingly violate certain Treasury Auction and Federal Reserve Bank requirements.
 - Auction file documentation is incomplete or not maintained for the required record retention period thereby violating regulatory requirements, exposing the firm to potential regulatory fines, legal proceedings, and/or disciplinary action.
 - Recording errors result in violations of the Treasury's NLP threshold, which exposes the firm to potential regulatory fines, disciplinary action and/or reputational risk.



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II. Audit Guidelines

II. AUDIT GUIDELINES

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>A. Written Policies and Procedures</p>		
<p>1. <u>Outdated Treasury Auction Policies</u></p> <p>Treasury auction policies and procedures are not in compliance with current regulations.</p> <p>Treasury auction policies and procedures are not adhered to.</p>	<ul style="list-style-type: none"> • Treasury Auction policies and procedures are reviewed and approved at least annually reflecting new guidance from Treasury. • Treasury Auction Compliance oversees Treasury Auction process to verify adherence to written procedures and policies. 	<ul style="list-style-type: none"> • Review the firm’s Compliance Educational Memorandums related to Treasury Auctions, Uniform Offering Circular Amendments and interpretations, which can be seen at (http://www.publicdebt.treas.gov/gsr/gsuocam.htm) and any relevant information received regarding the treasury auction process. • Verify that the firm’s procedures are up-to-date with Treasury Auction Rules and Best Practices. The Auction Rules may be found at TreasuryDirect.gov website by visiting http://www.treasurydirect.gov/instit/statreg/auctreg/auctreg.htm. Best Practices have been distributed to all firms through the treasury's Dealer Visit Program. • Interview key personnel responsible for the auction process and discuss current auction procedures. • Confirm that Compliance verifies that written policies and procedures are adhered to. • Verify that Compliance has attended every auction.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
B. Trading & Sales		
<p>1. <u>Preparing for Auction</u></p> <p>The firm is not operationally prepared to participate in the Auction.</p>	<p>The firm follows the TAAPS® Best Practice Guidelines distributed by SIFMA, and creates a checklist to document that the steps below are adhered to, which is then signed off by Operations/Trade Support and Compliance.</p> <ol style="list-style-type: none"> 1. Operations/Trade Support reviews each Treasury auction offering announcement for any change to the terms and conditions. 2. Operations/Trade Support logs on to two TAAPS® terminals at least 90 minutes prior to the competitive auction closes, and has established an icon for the TAAPS® “internet” URL at both Primary and Disaster Recovery (DR) sites. 3. Operations/Trade Support monitors all bids to ensure that customers do not place non-competitive and competitive bids in the same Operations/Trade Support sets up clients in TAAPs to ensure the correct naming convention is used (non-comp bids = last name-first name; trusts =full name or title of the trustee or fiduciary, date of execution, and employer identification number; institutions=full legal name and a bidder ID (if assigned); etc.). 4. Operations/Trade Support calculates the firm’s Net Long Position (“NLP”) as/of 30 minutes prior to competitive close. Operations/Trade Support confirms the reporting thresholds are within guidelines 	<ul style="list-style-type: none"> • Utilizing the U.S. Treasury website www.treasurydirect.gov determine population of U.S. Treasury auctions held within past year. Choose a judgmental sample of ~15% U.S. Treasury auctions (ensure that a representative sample of auctioned products is included). In addition, select one (1) live auction as part of the sample. Review the TAAPS® Best Practice Checklist (Exhibit A) for each sampled Auction to verify that it is signed off by Treasury Auction Operations / Trade Support as well as Compliance

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
	<p>and that all affiliates have submitted/not updated their close of the business day position. Operations/Trade Support also retains all NLP documents (faxes and emails) with the NLP calculation worksheet.</p> <p>5. Operations/Trade Support ensures that all customer and house bids are clearly recorded on forms prior to entry into TAAPS®. Operations/Trade Support ensures that the Head Auction trader and the Sales manager have reviewed the bids prior to input. Additionally, second operations / trade support representative validates all bids entered into TAAPS® by the primary operator.</p>	
<p>2. <u>Trading</u></p> <p>Auction bids are not accurately booked or unauthorized resulting in improper activity and violations of U.S. Treasury Auction requirements.</p>	<ul style="list-style-type: none"> • Operations / Trade Support ensures that approved trade details are correctly entered into the TAAPS terminal, and signed by the Head Trader. This should be evidenced via an “auction summary worksheet”. Data verified includes: <ul style="list-style-type: none"> ✓ Security description ✓ CUSIP ✓ Offers and the size of each bid ✓ The calculation of the net long position ✓ Net long position may be a negative number ✓ The reportable net long position can be reported as blank, zero, or a number • For any customer bids, Operations / Trade 	<ul style="list-style-type: none"> • Utilizing the U.S. Treasury website www.treasurydirect.gov determine population of U.S. Treasury auctions held within past year. Choose a judgmental sample of ~15% U.S. Treasury auctions (ensure that a representative sample of auctioned products is included). • For a sample selected, verify that the information on the “auction summary worksheet” matches the information entered into TAAPS for accuracy. • For Customer bids, the “Customer Auction Bid Worksheet” is fully documented along with relevant support. • The Compliance File is complete with necessary documentation.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
	<p>Support ensures that customer request matches approved trade detail as well as details entered in TAAPS. This should be evidenced via a “customer auction bid worksheet”. Additional data should include:</p> <ul style="list-style-type: none"> ✓ Salesperson name ✓ Evidence of authorization from customer ✓ RR# ✓ Date ✓ Security Description ✓ CUSIP and competitive bid. ✓ Bidder ID (if available) <ul style="list-style-type: none"> • Compliance or Operations / Trade Support should review and retain the following documents for internal records in a “Compliance File” <ul style="list-style-type: none"> ✓ Evidence of review of the Auction process by Compliance ✓ Treasury Auction Results Notification ✓ Auction Results Press Release ✓ Compliance Memorandum 	

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>3. <u>Trading Supervision</u></p> <p>Treasury traders are not properly supervised, which may result in improper business activities and violations of U.S. Treasury Auction requirements.</p>	<p>An appropriate, qualified supervisor reviews all proprietary bid submissions, customer bid forms submitted, and the NLP calculation performed by Operations / Trade Support via a Checklist as evidence of his/her review and approval.</p>	<ul style="list-style-type: none"> • For the selections made above, verify that an appropriate qualified supervisor has evidenced his/her review of auction documentation.
<p>4. <u>Customer Bid Submissions & Awards</u></p> <p>Customers are not notified of their reporting requirements for bid submissions in excess of \$100mm and awarded bids in excess of \$2b causing reputational harm, as well as potential regulatory fines and/or penalties.</p>	<p>Customers bidding in excess of \$100MM and / or with awarded bids in excess of \$2b are informed by Sales personnel of the NLP reporting requirements to the Fed. This communication should be documented and reviewed by an appropriate, qualified supervisor.</p> <p>Additionally, an appropriate, qualified supervisor should verify that all customer bid forms are signed by the Sales Manager as well as supervisor (i.e., an attestation that the customer was informed of the requirements).</p>	<ul style="list-style-type: none"> • Identify the processes by which the firm customers are informed of their auction reporting requirements. • Determine whether any customer bids and/or awards meet the reporting criteria from the sample selected and evaluate the customer notification process. • If any customer’s bids for more than \$100mm in securities, verify that customer was notified of the NLP reporting requirements. If the Customer advised the firm of their NLP, determine if the customer’s NLP was reported correctly. • If a customer is awarded \$2b or more of securities, determine if the customer was notified that it must provide a signed statement to the Federal Reserve Bank of New York by 10:00 A.M. on the day following the auction. • Verify review by an appropriate, qualified supervisor.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>5. <u>U.S. Treasury Contingency Procedures</u></p> <p>The U.S. Treasury Trading Desk has not prepared and/or tested their contingency procedures as required by the U.S. Treasury, consequently, resulting in costly business interruptions and /or loss of data in the event of a disaster or system failure.</p>	<ul style="list-style-type: none"> • The U.S. Treasury Auction Desk Head has reviewed and explained the Compliance Department’s Auction Procedures to all relevant trading and support functions to ensure that all parties involved in the U.S. Treasury Auction process are aware of the Firm’s contingency procedures. • In the event the TAAPS is down, the firm can submit bids to the FRBNY via telephone, which in turn faxes a confirmation of the submitted bid back to the firm. • The Treasury Trading Desk has identified key systems in their Business Impact Analysis (“BIA”) and has tested the applications at the off-site facility. • Quarterly Live U.S. Treasury auctions are held at the Disaster Recovery site. • The U.S. Treasury Desk participates in the annual SIFMA industry-wide connectivity test. • The U.S. Treasury Desk participates in any “mock” auctions held by the U.S. Treasury/Federal Reserve Bank to test ability to participate in manual auctions if TAAPS becomes unavailable. • A Government Emergency Telecommunication Service (“GETS”) card listing is current, maintained, training provided (as necessary) and recipients are advised to test periodically. 	<ul style="list-style-type: none"> • Evaluate the adequacy and completeness of Fixed Income Trade Support’s Contingency Auction Procedures. • Verify that the U.S. Treasury Trading Desk including all key systems for the Treasury Auction were tested. • Verify that the quarterly Live U.S. Treasury auctions were held at the Disaster Recovery site. • Verify that the U.S. Treasury Desk participated in the annual SIFMA industry-wide connectivity test. • Verify that U.S. Treasury Desk participated in any “mock” auctions held by the U.S. Treasury/Federal Reserve Bank. Note: U.S. Treasury “blast dial” call and Manual Mock Auction Obtain GETS card listing, review that it is current by comparing to FI organization chart and that the GETS program is included in the annual training program. • Visit and observe at least one of the contingency tests annually.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
C. Trade Support		
<p>1. <u>Net Long Lost Position (NLP) Calculation & Reporting</u></p> <p>The calculation of NLP does not include data from all the firm affiliates as required by the single bidder status, and / or the calculation methodologies are inconsistent causing the NLP calculation to be misstated and not properly reported to the Fed based upon the Treasury's NLP Reporting requirements. (Current threshold 35%)</p>	<ul style="list-style-type: none"> • Fixed Income Trade Support obtains the auctioned CUSIP positions from trading desks and affiliates and aggregates the total position in auctioned security to ensure the firm is within the NLP Reporting threshold. (Current threshold 35%) • Fixed income Trade support is familiar with the most current compliance around NLP Reporting (Statute 356.13a) • If automated, the NLP calculation is tested for accuracy periodically and upon change. 	<ul style="list-style-type: none"> • Using the sample of Treasury Auctions selected for trade testing, verify that Fixed Income Trade Support sends auction notifications to the firm's affiliates timely (prior to the auction) and that responses received from all affiliates were received prior to the auction NLP reporting deadline. • Recalculate the NLP plus current bids and verify that if the total exceeded the 35% reporting threshold that the appropriate reports were sent to the Fed. • If automated, verify user testing of calculation.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>2. <u>Trade Capture & Recording</u></p> <p>U.S. Treasury auction bids are not recorded, recorded inaccurately, or lost during the transference of information between front office applications and downstream systems, resulting in misstated Firm records and violations of the Treasury’s NLP threshold, thereby exposing the firm to potential regulatory fines, disciplinary action and/or reputational risk.</p>	<ul style="list-style-type: none"> • Trade information is input into the front office System which feeds the firm’s books and records. Control points exist to verify completeness and accuracy of data feeds. • Fixed Income Trade Support performs a daily reconciliation between Front Office and GL System’s. 	<ul style="list-style-type: none"> • Document data flow between front office systems and back office systems. Identify control points that verify completeness and accuracy of data feeds. Verify operating effectiveness of control points. • Using the sample of Treasury auctions selected, ensure the accuracy of the firm’s books and records by verifying that trade information is accurately captured in front office and back office systems, including but not limited to the bid, acceptance of the bid and the settlement of the security. • Obtain and review a sample of Fixed Income Trade Support’s daily reconciliations between Front Office, books and records systems and GL Systems. Verify that the reconciliations were performed daily and that discrepancies were investigated and resolved timely.
<p>3. <u>Auction File Documentation</u></p> <p>Auction file documentation is incomplete or not maintained for the required record retention period thereby violating regulatory requirements, exposing the firm to potential regulatory fines, legal proceedings, and/or disciplinary action.</p>	<ul style="list-style-type: none"> • Fixed Income Trade Support maintains auction file documentation and reviews for completeness against a standardized documentation checklist. • All auction and NLP calculation documentation is maintained on file for 3 years (2 years in a readily accessible place). 	<ul style="list-style-type: none"> • Using the sample of Treasury auctions selected, ascertain whether pertinent documents (e.g., documents referenced on the U.S. Treasury Auction Supervisory Review Checklist) were maintained within each of the auction files and supervisory review evidenced. • Request to see auction files from off-site storage to determine whether they are maintained in a readily accessible location. • For the Treasury Auctions sampled, verify that an Auction Summary Worksheet is maintained.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
D. Information Technology		
<p>1. <u>Application / Database Security</u></p> <p>User access to the TAAPS terminal and TAAPS tokens/keys are not periodically reviewed / verified to evaluate access rights and functionality which may lead to unauthorized trading activity and compromised data and system integrity.</p> <p>TAAPS tokens/keys are not properly safeguarded.</p>	<ul style="list-style-type: none"> • User access to TAAPS terminal is periodically reviewed to ensure appropriate access rights. • TAAPS token/keys are physically secured. • An up-to-date list of authorized TAAPS users (i.e. TAAPS EUAC [End User Authorization Contact] Designation and Authorization) was submitted to FRB NY, based on information sent to Compliance by the U.S. Treasury Auction Desk Head. This is part of Appendix B of the Annual Agreement. 	<ul style="list-style-type: none"> • Ascertain whether the TAAPS terminal is password protected, and only authorized personnel can access the terminal. • Verify that TAAPS token/keys are physically secured at main office and DR site. The concern is to ensure that the tokens are secure and readily accessible, and only those individuals who have access to TAAPs can access the tokens. • Obtain current, list of authorized TAAPS users (EUAC) submitted to FRB from Compliance and verify that the users listed are appropriate.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
E. Compliance and Legal		
<p>1. <u>Compliance Monitoring</u> Compliance has no effective means of monitoring U.S. Treasury auction activity and accordingly cannot verify the Firm's compliance with regulatory reporting requirements thereby exposing the Firm to potential regulatory fines and/or disciplinary action.</p>	<ul style="list-style-type: none"> • The Firm's has adequate U.S. Treasury Auction Compliance Procedures meeting regulatory requirements. • A member of the Fixed Income Compliance area is present at all U.S. Treasury auctions to help ensure the Firm's compliance with regulatory and firm policies as evidenced by his/her signature on the Supervisory Review Checklist. • Compliance maintains current copies of the Submitter and End User Authorized Contact (EUAC) agreements; the signed Strategic Plan for Business Continuity with current contact list of key auction personnel; and the Disaster Recovery (DR) site procedures. 	<ul style="list-style-type: none"> • Evaluate Compliance's procedures to monitor U.S. Treasury Auction processes, policies and procedures. • From sample selected for Testing of Treasury Auction, verify Compliance attendance at each auction as evidenced by Compliance representative signature on the Supervisory Review Checklist. • Review the files that Compliance maintains which includes current copies of the Submitter and End User Authorized Contact (EUAC) agreements, the signed Strategic Plan for Business Continuity with current contact list of key auction personnel, and the Disaster Recovery (DR) site procedures.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>2. <u>Certifications/Agreements</u></p> <p>The firm is not submitting required agreements and the semiannual and annual certifications causing the Firm to violate its agreement with the Fed and thereby exposing the firm to potential regulatory fines and/or disciplinary action.</p>	<ul style="list-style-type: none"> • U.S. Treasury Auctions Submitter Agreement is current. • Firm sent Semi-Annual Compliance Disclosure to FRB NY for six-month periods ending June 30 and December 31. • Firm is trained and aware of procedures that need to be in place for Annual Certification requirements. FRB NY annual certification requires the firm to attest that “policies and procedures are reasonably designed to promote adherence to the Treasury Market Best Practices Guidelines” and the completion of appropriate testing to confirm compliance with the Guidelines. (See Exhibit A) 	<ul style="list-style-type: none"> • Verify that U.S. Treasury Auction submissions are made in accordance with Treasury Auction Rules and any primary dealer agreements with the Fed. • Obtain and verify that the Firm sent Semi-Annual Compliance Disclosure to FRB NY (Most Recent). • Evaluate Front Office and Compliance awareness of the Annual Certification requirements.
<p>3. <u>Compliance Training</u></p> <p>Fixed Income personnel are not properly trained on the Firm’s contractual and regulatory requirements as a Primary Dealer of U.S. Treasury Securities and could therefore cause the Firm to unknowingly violate certain Treasury Auction and Federal Reserve Bank requirements.</p>	<ul style="list-style-type: none"> • A Compliance Officer conducts specialized training for all Fixed Income employees that transact and process U.S. Treasury auctioned securities with a specific segment of the training related to the Firm’s contractual and regulatory requirements as a Primary Dealer. • Training participants are required to sign-in at each training session as evidence of their attendance. 	<ul style="list-style-type: none"> • Obtain and evaluate the most recent Fixed Income Compliance training materials and verify that it includes Treasury Auction related training. • Obtain the sign-in sheet and verify that the required employees (including new hires since last annual training) take part in Treasury Auction related training at least annually.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Risks to be Managed	Types of Controls to Manage/Eliminate Risks	Potential Audit Work Steps
<p>4. <u>Required Filings</u> Auction file documentation is incomplete or not maintained for the required record retention period thereby violating regulatory requirements, exposing the firm to potential regulatory fines, legal proceedings, and/or disciplinary action.</p>	<ul style="list-style-type: none"> • Operations / Trade Support and/or Compliance personnel are to maintain a current list of all required filings that includes all personnel listed on each document. • Updated forms are filed as changes are made to the documents and/or the personnel included on the documents. The firm maintains checklist or some other means to verify / monitor all filings. 	<ul style="list-style-type: none"> • Based on a review of current filing requirements and discussions with Trading Desk, Operations / Trade Support and/or Compliance personnel, determine if the filings are current and monitored and the personnel listed on these forms are current employees and the individuals assigned are appropriate.



Internal Auditors Society

III. Glossary

III. GLOSSARY

The definitions in this section shall apply to the terms used in the guideline. Where terms are not defined in this section or within another chapter, they shall be defined using their ordinarily accepted meanings within the context in which they are used.

Affiliate	<p>Applies to an entity >50% owned by a corporation or partnership</p> <p>Not an affiliate if:</p> <ul style="list-style-type: none">-Ownership is for investment purposes only-Owner doesn't routinely exercise operational or management control-Owner doesn't exercise any control over investments in Treasury securities
Customer	<p>A bidder that directs a depository institution or dealer to submit or forward a bid for a specific amount of securities in a specific auction</p> <ul style="list-style-type: none">-Customers are bidders; they range from individuals to hedge funds-Large-Customer certifications — applies to those awarded \$2 billion or more-Not a submitter
FRB	Federal Reserve Bank
Fixed Income	Any type of investment that is not equity , which obligates the borrower/issuer to make payments on a fixed schedule, even if the number of the payments may be variable.
GETS	The Government Emergency Telecommunications Service ("GETS") is a White House-directed emergency phone service provided by the National Communications System ("NCS") in the Office of Cybersecurity and Communications Division, National Protection and Programs Directorate, Department of Homeland Security. GETS supports Federal, State, local, and tribal government, industry, and non-governmental organization ("NGO") personnel in performing their National Security and Emergency Preparedness ("NS/EP") missions. GETS provides emergency access and priority processing in the local and long distance segments of the Public Switched Telephone Network ("PSTN"). It is intended to be used in an emergency or crisis situation when the PSTN is congested and the probability of completing a call over normal or other alternate telecommunication means has significantly decreased.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Net Long Position (“NLP”)	When all open long positions and open short positions in an account are offset against each other, either a surplus of long or of short positions results. This is referred to as a "net-long" or "net-short" position.
Primary Dealer	A primary dealer is a bank or securities broker-dealer that is permitted to trade directly with the Federal Reserve System .
STRIPS	"STRIPS" stands for Separate Trading of Registered Interest and Principal Securities. An investment firm will usually buy a debt instrument and "strip" it into its separate parts. Strip bonds usually trade at a discount and mature to par value.
Submitter	<p>A person or entity submitting bids directly for its own account, for customer accounts, or Both.</p> <p>Only depository institutions and dealers may submit bids for customers.</p>
TAAPS	TAAPS is an application for the exclusive use of institutions that provides direct access to U.S. Treasury auctions. This system electronically receives and processes tenders sent into U.S. Treasury auctions. It allows institutions to purchase marketable securities directly and reduce or eliminate intermediary costs, bringing direct bidding to your desktop.
TreasuryDirect	TreasuryDirect is the only financial services website that allows individuals and corporations to purchase, i.e., submit and be awarded bids on a noncompetitive basis, and subsequently redeem securities directly from the U.S. Department of the Treasury in paperless electronic form.
Uniform Offering Circular (UOC)	The UOC sets out the terms and conditions for the sale and issue of marketable Treasury bills, notes, and bonds. The UOC describes these securities, how they are auctioned, including how to submit bids, and the authorized payment methods.

Appendix A

Suggested "Best Practices" for TAAPS® Submitters Participating in Treasury Marketable Securities Auctions

This document provides TAAPS® submitters with suggested best practices for participating in Treasury auctions. Our goal is to help submitters reduce operational risk and potential errors when participating in Treasury auctions. To achieve this goal, we suggest including the following best practices in your auction processes/procedures:

Operations/Trade Support Staff

- Review each Treasury auction offering announcement since the terms and conditions are subject to change at any time.
- Log on (Operations staff) to TAAPS® (Treasury Automated Auction Processing System) from a minimum of two terminals at least 90 minutes prior to the competitive close. Primary Dealers should consider either establishing an icon or bookmarking the TAAPS® “internet” URL on the TAAPS® input computers at both Primary and Disaster Recovery (DR) sites to ensure a backup method exists in the event of a direct connection (VPN) failure.
- Monitor bids to ensure that customers do not place noncompetitive and competitive bids in the same auction. For noncompetitive bids, individuals should be listed in last name-first name order. Bids for trusts require the full name or title of the trustee or fiduciary, date of execution, and employer identification number. Bids from institutional customers or corporations require full legal name and a bidder identification number (BIN), if Treasury has assigned a BIN to the bidding entity.
- Calculate the firm’s net long position (NLP) in the auctioned security as of 30 minutes prior to competitive close (see §356.13(b) of the Uniform Offering Circular (“UOC”) for NLP calculation time requirement). Details of the NLP requirements, including the reporting threshold provision, can be found at the following link: http://edocket.access.gpo.gov/cfr_2009/julqtr/31cfr356.13.htm. Overseas affiliates that are closed at the time of the calculation and whose positions/holdings are on separate trading platforms should submit their position at the end of the business day prior to the auction date. NLP documents (faxes and emails) from affiliates should be retained with the NLP calculation worksheet, including faxes and e-mails.
- Be knowledgeable of Treasury auction emergency bidding procedures. We recommend each firm have a copy of the emergency bidding guidelines at its TAAPS® input computers in case of a contingency.
- Record bids on the firm’s standard customer and house (proprietary) bid forms/sheets prior to entry into TAAPS®. We suggest that traders and/or sales representatives sign off on bids that are submitted for TAAPS® input. We recommend that a second firm representative with oversight responsibilities validate the auction bids placed by the TAAPS® operator. Last minute trader/salesperson call-out orders should be documented, signed, and delivered promptly to the operations/trade support/compliance representative responsible for bid verification.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Monitoring Auction Rules Compliance (Legal & Compliance Staff)

- Be familiar with the relevant information on the TreasuryDirect.gov website, particularly the UOC, which can be found at <http://www.treasurydirect.gov/instit/statreg/auctreg/auctreg.htm>.
- Ensure that Treasury auctions are monitored for compliance with the rules.
- Ensure that auction procedures that detail the firm's auction processes are updated.
- The auction compliance manual should specifically outline the roles and responsibilities of each business unit involved in the Treasury auction process.
- The firm's auction compliance manual should include current copies of the following documents:
 - Submitter and End User Authorized Contact (EUAC) agreements, and
 - Autocharge agreements (if applicable). For Primary Dealers:
 - The signed Strategic Plan for Business Continuity with current contact list of key auction personnel; and
 - The DR site procedures, including TAAPS® token storage and retrieval.
- Ensure that a Compliance representative is present at each auction to provide auction rules guidance.
- Ensure Treasury trading/sales and operations / trade support personnel are informed of all auction rule changes.
- Verify the NLP calculation prior to competitive close. If polling information from affiliates, Treasury recommends listing the NLP components on the NLP worksheet, and retaining the calculation sheet and affiliate supporting documentation (e.g., faxes and emails, etc.) in the auction folder.
- Observe and verify TAAPS® bid entry. If bids are being entered at a different location, Compliance should obtain TAAPS® “view-only” access to monitor bids in real time.
- Verify that all auction documentation is properly prepared, approved, and retained in the auction folder after the auction close. Treasury recommends that each auction folder contain the auction announcement, results, TAAPS® bid screen printouts, customer and house bid sheets, TAAPS® award notices, and signed NLP worksheet with supporting fax and email documentation.
- Hold periodic staff training that covers auction rules and procedures, and documents participant attendance. New staff should be trained before participating in the Treasury auction process.
- Provide Treasury/FRB New York with a current list of key auction contacts and update the list when key personnel changes occur.
- Report auction errors/violations to a Treasury or FRB New York auction compliance official promptly.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

Auditing Auction Participation (Audit Staff)

- Review the entire auction process and ensures that it conforms to all Treasury auction rules and guidance, and the firm's auction procedures. Auditors should stay up-to-date on all rule changes, and verify that auction procedures and operational processes are accurate.
- Audit the Treasury auction process annually.
- Audit the records of at least 10% of all auctions that the firm participated in, including at least one of each security type. For entities with TAAPS bid input capabilities at the DR facility: Treasury recommends that Audit review a live auction conducted from the disaster recovery site.
- Ensure audit coverage includes live and historical auctions. Treasury recommends unannounced visits that include a review of the firm's NLP calculation process.
- Audit reviews should include customer bids, from the acceptance of the bid by the sales representative through the settlement of the security.
- Audit verifies that all organizational components within the single bidder entity are included in NLP calculations and that the position data supplied by both domestic and foreign affiliates is accurate.

Business Continuity (for Primary Dealers)

- Conduct a live Treasury auction from the firm's business resumption (disaster recovery) site each quarter. Prior to the auction, notify FRB New York auction staff that your firm will be submitting auction bids from the business resumption site.
- Ensure TAAPS tokens stored at the business resumption site are secure, but readily accessible to the firm's auction staff. When conducting a live auction or testing from the business resumption site, primary dealer auction bid input staff should use their disaster recovery (DR) tokens.
- Participate once a year (or whenever announced by Treasury) in a same-day manual mock auction with Blast Dial communication and phone submission of auction bids.
- Participate in a yearly Federal Reserve sponsored Business Resumption Test (BRT), and the annual SIFMA industry-wide business continuity test.
- Ensure that staff members essential to conducting Treasury auctions have Government Emergency Telephone Service (GETS) cards and/or Wireless Priority Service (WPS) capability, and test access on a semiannual basis.

Security - Controlling Access to TAAPS

- The firm's EUAC verifies the necessity for access and legitimacy of all designated TAAPS users, and notifies FRB New York TAAPS Technical Support staff of any changes in access. When a TAAPS user leaves the firm, his/her token should be collected and FRB New York TAAPS Technical Support contacted to disable TAAPS access.
- Firms complete the annual access reviews to verify access to TAAPS.

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

General Suggestions

- Compliance, audit, and operations / trade support staff sign up for auction announcements/results, and rule change email notifications on the TreasuryDirect.gov website. <http://www.treasurydirect.gov/maillist/maillist.htm>
- Compliance, audit, and operations / trade support staffs consider attending the bi-annual auction rules training presented by Treasury at FRB New York.

Disclaimer

This is not a set of binding rules or regulatory guidance, and it does not encompass all aspects of the auction process. Therefore, in addition to these suggestions, we strongly urge everyone involved in the auction process to become knowledgeable of the auction rules.

<http://www.treasurydirect.gov/instit/statreg/auctreg/auctreg.htm>

Appendix B

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239



Embargoed Until 11:00 A.M.
January 23, 2012

CONTACT: Office of Financing
202-504-3550

TREASURY OFFERING ANNOUNCEMENT¹

Term and Type of Security	28-Day Bill
Security Description	4-Week Bill
Offering Amount	\$30,000,000,000
Currently Outstanding	\$56,003,000,000
CUSIP Number	912795Z38
Auction Date	January 24, 2012
Original Issue Date	August 25, 2011
Issue Date	January 26, 2012
Maturity Date	February 23, 2012
Maximum Award	\$10,500,000,000
Maximum Recognized Bid at a Single Rate	\$10,500,000,000
NLP Reporting Threshold	\$10,500,000,000
NLP Exclusion Amount	\$19,700,000,000
Scheduled Purchases in Treasury Direct	\$0
Minimum Bid Amount and Multiples	\$100
Competitive Bid Rate Increments ²	0.005%
Maximum Noncompetitive Award	\$5,000,000
Eligible for Holding in Treasury Direct Systems	Yes
Eligible for Holding in Legacy Treasury Direct	No
Estimated Amount of Maturing Bills Held by the Public	\$83,020,000,000
Maturing Date	January 26, 2012
SOMA Holdings Maturing	\$6,285,000,000
SOMA Amounts Included in Offering Amount	No
FIMA Amounts Included in Offering Amount ³	Yes
Noncompetitive Closing Time	11:00 a.m. ET
Competitive Closing Time	11:30 a.m. ET

¹ Governed by the Terms and Conditions set forth in The Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended), and this offering announcement.

² Must be expressed as a discount rate with three decimals in increments of 0.005%, e.g., 7.100%, 7.105%.

³ FIMA up to \$1,000 million in noncompetitive bids from Foreign and International Monetary Authority not to exceed \$100 million per account.

Appendix C

March 25th, 2011 memo from the Federal Reserve Bank of New York

The Background and Program Description below is from a March 25th, 2011 memo from the Federal Reserve Bank of New York that set out the guidelines on the Primary Dealer Compliance Program:

I. Background

“The Policy for Administration of Primary Dealer Relationships, as stated in a memo from the FRBNY, as revised in January 2010, states that “[t]he New York Fed expects a primary dealer to maintain a robust compliance program, including procedures to identify and mitigate legal, regulatory, financial, and reputational risks,” and that the Bank “may limit access to any or all of the primary dealer facilities or operations, and may suspend or terminate a primary dealer if it appears, in the New York Fed's judgment, to have an inadequate or weak control environment.” Further, the Policy gives the New York Fed discretion to limit access to facilities or suspend or terminate the primary dealer relationship “if a primary dealer becomes the subject of, or involved with, regulatory or legal proceedings that, in the judgment of the New York Fed, unfavorably impacts the primary dealer relationship.”

The Primary Dealer Compliance Program is the principal means by which the New York Fed will monitor compliance with the Policy. The New York Fed continues to emphasize, however, that the nature of its relationship with primary dealers is a counterparty relationship, and not a regulatory one. The Primary Dealer Compliance Program is an effort by the New York Fed to manage its counterparty risk consistent with its mandates to implement monetary policy and promote financial stability. It is not, and should not be viewed as, a regulatory examination, nor should it be viewed as a replacement for prudent counterparty risk management and due diligence by third parties.

II. Program Description

The Primary Dealer Compliance Program has three components, as follows:

1. Semiannual Disclosure

At the end of the second calendar quarter in 2011, and semiannually thereafter, primary dealers will submit a disclosure to the New York Fed. The disclosure will state whether, in the preceding six-month period, the legal entity which is the primary dealer (“Firm”) or its employees (a) became subject to, or reached a resolution, including settlement, regarding material litigation involving business lines or activities directly related to the primary dealer relationship, (b) received notice of a regulatory enforcement action or proceeding involving the primary dealer, or (c) experienced a Significant Compliance Matter. The term “Significant Compliance Matter” means: (i) a finding, by a regulatory authority or court of competent jurisdiction, that the Firm violated federal or state securities laws; (ii) a material breach of the Firm's compliance or risk management policies and procedures, provided such breach occurs in a business line or activity that is directly related to the

SIFMA Internal Audit Guidelines for U.S. Treasury Auctions

primary dealer relationship; or (iii) any deviation from the Treasury Market Best Practices Guidelines that may have a material impact on the primary dealer relationship.

2. Annual Certification

Primary dealers will also be required to file, not later than thirty calendar days after the end of calendar year 2011, and annually thereafter, a certification by the Firm's principal business contact with the New York Fed and countersigned by its chief compliance officer stating that, at all times during the relevant period, the Firm had in place policies and procedures reasonably designed to promote adherence to the Treasury Market Best Practices Guidelines and that the Firm has completed appropriate testing to confirm compliance with those Guidelines.

3. Enhanced Review Process

In some cases, the New York Fed may undertake a review of the business relationship with an existing primary dealer. It is intended that this enhanced review process will be reserved for exceptional circumstances where there is an apparent risk, in the sole discretion of the New York Fed that continuing the primary dealer relationship would present heightened credit, reputational, or other risk to the New York Fed. The New York Fed will determine what form of enhanced review is appropriate in any particular case based on the facts presented. The form such review could take includes, without limitation: (a) discussions with the management, compliance, or internal audit staff of the Firm or any affiliated entity (together, the "Institution"); (b) appointment of an independent third-party to conduct an investigation and issue a report; (c) consultation with the primary regulator (including, where applicable, Bank Supervision personnel within the Federal Reserve System) about the primary dealer's control environment; (d) detailed review of the Institution's compliance and risk management policies and procedures; or, in extraordinary cases, (e) on-site review and testing of the Institution's controls or an inquiry led by the New York Fed's Legal Group concerning the facts and circumstances associated with an event. For illustrative purposes only, the New York Fed might initiate an enhanced review process following: (i) a criminal indictment of the Institution (or an affiliated person or entity) or other such information or disposition from a criminal authority; (ii) the occurrence of a Significant Compliance Matter; (iii) the initiation of regulatory action (including the filing of civil litigation by a regulator) or investigation by a legislative body concerning alleged misconduct in business lines or activities directly related to the primary dealer relationship; or (iv) an adverse judgment, settlement of civil litigation, or sanction by the Institution's primary regulator or exchange if the claim or violation concerned business lines or activities directly related to the primary dealer relationship.”

Helpful Links

Public Debt's website (www.treasurydirect.gov)

<http://www.treasurydirect.gov/instit/statreg/auctreg/auctreg.htm>

U.S. Treasury – Under —Offices (www.treas.gov)

FRBNY's website (www.ny.frb.org)

The Audit Guidelines (the "guidelines") are intended to provide members of the Internal Auditors Society ("IAS"), an affiliate of the Securities Industry and Financial Markets Association ("SIFMA") with information for the purpose of developing or improving their approach towards auditing certain functions or products typically conducted by a registered broker-dealer. These guidelines do not represent a comprehensive list of all work steps or procedures that can be followed during the course of an audit and do not purport to be the official position or approach of any one group or organization, including IAS or any of its divisions or affiliates. Neither IAS, nor any of its divisions or affiliates, assumes any liability for errors or omissions resulting from the execution of any work steps within these guidelines or any other procedures derived from the reader's interpretation of such guidelines. In using these guidelines, member firms should consider the nature and context of their business and related risks to their organization and tailor the work steps accordingly. Internal auditors should always utilize professional judgment in determining appropriate work steps when executing an audit.