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VIA FEDERAL EXPRESS & EMAIL

December 10, 2003

The Honorable Brian C. Roseboro
Assistant Secretary for Financial Markets
United States Treasury Department
1500 Pennsylvania Avenue, N.W.
Washington D.C. 20220-0002

Re: The Potential Disruption of a Scheduled Auction of U.S. Treasury Securities

Dear Mr. Roseboro:

The Treasury Department ("Treasury") had previously indicated that it was developing contingency plans for responding to potential disruptions to the Treasury auction process. As part of the development process, Treasury requested public comment regarding (i) the circumstances under which Treasury should consider postponing an auction and (ii) the factors to be considered in deciding whether or not to postpone an auction.

The Bond Market Association¹ (the "Association") is pleased that Treasury is addressing an issue that the Association and both its Primary Dealers Committee² and the Treasury Borrowing Advisory Committee³ regard as of great importance. We welcome this opportunity to offer some suggestions.

¹ The Association represents securities firms and banks that underwrite, distribute and trade in fixed income securities, both domestically and internationally, including all primary dealers recognized by the Federal Reserve Bank of New York. Our members are also actively involved in the funding markets for such securities, including the repurchase and securities lending markets. Further information regarding the Association, its members and its activities can be obtained from our public website: <http://www.bondmarkets.com>.

² The Primary Dealers Committee is made up of senior representatives from the primary dealers in United States government securities whose names appears on the "List of the Government Securities Dealers Reporting to the Market Reports Division of the Federal Reserve Bank of New York" ("Primary Dealers") and inter-dealer brokers who serve as conduits between the Primary Dealers in the Treasury and federal agency securities markets.

³ The Treasury Borrowing Advisory Committee of the Association (the "Borrowing Committee") is an advisory committee established by federal statute that meets quarterly at the Treasury Department. The Borrowing Committee's membership is comprised of senior representatives from "buy-side" institutions and from a number of the major commercial and investment banks. The Borrowing Committee makes observations to Treasury on the overall strength of the U.S. economy as well as providing recommendations on a variety of technical debt management issues. The Association does not participate in the deliberations of the Borrowing Committee.

A. Overview

The Association applauds Treasury's efforts to develop and refine its auction contingency plans. Developing contingency plans and communicating in advance how Treasury may alter its auction and issuance schedule should help reduce market uncertainty in the event of an unanticipated disruption event.

As discussed further below, Treasury's identification of possible scenarios that might lead to a disruption in the Treasury auction process, along with Treasury's likely response to each scenario, will be particularly helpful in preserving market participant confidence in the auction schedule. Market participants, in general, and the Primary Dealers, in particular, need to have a better sense of the Treasury's likely response to different types of disruptions if they are to participate meaningfully in the Treasury auction process in a post-disruption event environment. At the same time, however, it is impossible to define or plan for every potential disruption. Therefore, the Association urges Treasury to be mindful of the importance of preserving its flexibility in order to be able to react to the unique factors associated with a particular disruption. The actual decision to postpone an auction must be made at the time of the incident, as it needs to be based on the nature, scope and duration of the problem and what parties are affected.

The Association believes that the financial industry's response to September 11 and to the August 2003 East Coast power outage have helped to highlight the need for Treasury to have a well-developed auction contingency plan and to define some of the key elements of a successful contingency plan. These include the ability to: (i) communicate immediately with key market participants and infrastructure providers in order to quickly assess the exact impact and scope of a disruption; (ii) modify existing contingency plans and procedures, as necessary, based on the specific circumstances and (iii) quickly communicate to auction participants a revised auction schedule (if any) and how any particular contingency plans and/or procedures will be implemented.

These elements, as well as other elements of a successful contingency plan, are discussed in greater detail in the "Discussion" section of this letter.

In particular, we recommend that Treasury focus its contingency efforts on insuring that Treasury and market participants can communicate effectively during a crisis. Treasury's communications policy should cover the following elements:

- 1. The ability to engage in real-time communications.** Treasury and the Federal Reserve Bank of New York ("FRBNY") should consider developing a back-up system for communications with the Primary Dealers during a disruption in order to ascertain the impact of the event and proper response.
- 2. Methods for immediately communicating to all market participants any changes to the auction schedule.** Treasury should consider developing and disseminating a formal communications plan detailing the various methods it will use to announce any revisions to the auction schedule. The Discussion section of the letter also suggests some additional steps that Treasury should consider in developing its auction contingency plan:

- Avoid cancellation of a scheduled auction once the when-issued trading period has begun.
- Encourage Primary Dealers to use back-up sites, overseas offices and telephones to participate in the auction in the event that a Primary Dealer cannot access the TAAPSLink auction system from its primary site.
- Consider expanding its list of potential disruption events and provide greater clarity regarding the anticipated Treasury responses to events that temporarily disrupt the secondary market or the dealer community in general.

B. Discussion

1. The Importance of Communicating Effectively with Market Participants during a Crisis

a. Engaging in Real-time Communication

Treasury and FRBNY must be able to assess, as quickly as possible, the impact of a disruption event on the primary market (especially the functioning of the new TAAPSLink auction system) and the secondary market. There are a wide range of possible scenarios that might lead to Treasury having to delay or postpone an auction. These scenarios typically fall into two main groups. The first group of scenarios involves a technical or operational problem (including a legal impediment, like potentially exceeding the debt ceiling) or systems failure particular to Treasury or the FRBNY. The second group of scenarios involves a sudden local or regional event that severely impacts the communications, power, data, systems, physical facilities or staff at multiple Primary Dealers and/or other key firms that support the primary and secondary markets (such as inter-dealer brokers, the Fixed Income Clearing Corporation or the clearing banks).

In the latter group of scenarios, it is essential that Treasury and FRBNY be able to engage in real-time communications with the Primary Dealers to learn whether any Primary Dealers have been directly affected by the disruption event, how they are affected, and what contingency plans or back-up services they can utilize to ensure their meaningful participation in a scheduled auction.

Likewise, senior management at each of the Primary Dealers needs to have the capacity to communicate with Treasury and FRBNY via more than one medium following a broader disruption event. Since the effects of a disruption will change over time, it is essential that the Primary Dealers be able to relay current market conditions to Treasury and FRBNY. This in turn will assist Treasury and FRBNY in formulating and adopting their contingency plans to specific circumstances.

The Association therefore recommends that Treasury and FRBNY consider the following objectives in developing an emergency communications plan:

- Treasury and FRBNY should have in place multiple communication media in the event that one becomes inoperable. At a minimum, Treasury and FRBNY should encourage the establishment and use of the following methods of communication: (i) messaging via

TAAPSLink; (ii) messaging via FedLine terminal; (iii) announcements released via public newswires services; (iv) a 1-800 number into which Primary Dealers may call and (v) ensure that senior traders at each Primary Dealer have Government Emergency Telecommunications Service ("GETS") cards.⁴

- Critical Treasury and FRBNY auction personnel should have an emergency contact list containing the office, home and cell phone numbers for senior management at each of the Primary Dealers.
- If time constraints make it impractical to survey the operating status of all Primary Dealers following a general disruption event, Treasury and FRBNY should use all reasonable efforts to survey the ten most active Primary Dealers, or those Primary Dealers that collectively have accounted historically for the majority of secondary market trading activity.

b. Utilizing Multiple Methods of Communicating any Revised Auction Schedule to Market Participants

A reliable and redundant communications infrastructure is critical to the efficient functioning of the Treasury market. Market participants should know in advance where to find up-to-the-minute information on the status of the Treasury market in case of a disruption event. To this end, Treasury and FRBNY should develop a formal communications policy to be disseminated to all Treasury market participants. This will minimize confusion and encourage greater market participation in the event of a revision to the auction schedule.

The Association also recommends that Treasury continue to participate as an observer in any emergency meetings of the Association's Calendar Committee as part of Treasury's overall efforts to coordinate its issuance activities during a crisis with the Primary Dealers as well as key market participants and infrastructure providers. The Association Calendar Committee has a well-recognized and longstanding role⁵ in establishing voluntary calendar recommendations for the secondary market for the U.S. dollar fixed income markets.⁶ These recommended trading hours help inform market participants of the reduced level of secondary market trading activity that is likely to occur either

⁴GETS provides specialized call processing in the event of congestion and/or outages during an emergency, crisis or war by providing GETS card holders with faster access to telecommunications than ordinary users.

⁵ General Accounting Office, "Potential Terrorist Attacks: Additional Actions Needed to Better Prepare Critical Financial Market Participants," Report to the Committee on Financial Services, House of Representatives (February 2003), at 46.

⁶ The TBMA Calendar Committee has historically made recommendations to its members regarding full close (holiday) and early close recommendations as well as trading hours recommendations for the U.S., U.K. and Asian U.S. dollar fixed income markets. These recommendations serve as a valuable part of the overall information flow to the marketplace by telling market participants in advance when trading activity, and therefore liquidity, is likely to be lower than normal. Compliance with all of the Association's recommendations is purely voluntary, and market participants who wish to conduct business in spite of lower than normal liquidity are free to do so.

around national holidays and due to unanticipated events like natural disasters, terrorist attacks or the August 2003 power outage.⁷

As part of a formal communication policy, the Association recommends the following elements:

- Treasury and FRBNY should consider making use of public media, such as television and radio - not just proprietary communication networks - when releasing an announcement with regard to a disruption event.
- Treasury and FRBNY should strongly consider creating an emergency 1-800 number where bidders can obtain information regarding details of any rescheduled auction.
- Where possible, announcements regarding an auction postponement and rescheduling should be released at a standard time, and ideally no later than two hours before the originally scheduled auction.
- Treasury should continue to utilize any emergency meetings of the Association's Calendar Committee as a source of real-time information during a broader disruption event about the degree to which the government securities markets are fully functioning.

2. General Principles that Should Guide Treasury's Contingency Planning.

In developing its auction contingency plans, the Association also recommends that Treasury strongly consider taking into account the following basic principles:

a. Avoid Cancellation of a Scheduled Auction

Once an auction has been announced and after when-issued ("WI") trading has commenced, Treasury should make every effort to avoid canceling the auction. As you know, the WI market⁸ plays an important role in reducing the uncertainties surrounding the auction distribution process by providing market participants with a price discovery mechanism. As a result, competitive bidders are more likely to bid confidently and aggressively, thereby reducing Treasury's cost of funding.

Given the importance of the WI market, canceling an auction after WI trading has begun is problematic for a number of reasons. First, it disrupts the price discovery process upon which market participants have come to rely. Second, it

⁷ For instance, the role of the Association in facilitating the cooperation of market participants in responding to the disruptions caused by the September 11 attacks has been widely noted. The Calendar Committee worked to foster agreement among market participants and key service providers to abbreviated trading hours in the days following September 11, 2001 and also recommended extended settlement periods for Treasury securities (T + 5) to ease pressures on the clearing system. The Calendar Committee also convened, and recommended an early close to the secondary markets, in response to the recent power outage that affected the northeastern United States.

⁸ The WI market refers to trading in a to-be-issued security that occurs between the release of a Treasury offering announcement and the actual issuance.

leads to weakened dealer and investor confidence in the WI market, thereby potentially increasing Treasury's cost of funding. Third, it could damage Treasury's and the dealer community's reputation among investors.

For these reasons, the Association recommends that, rather than cancel an auction once WI trading has begun, Treasury postpone an auction. If postponement and rescheduling of an auction for later the same day or the next business day is not possible, Treasury should consider reducing the size of the auction.⁹ Depending upon the type of disruption event and the number of market participants affected, Treasury may wish to modify the offering amount and/or suspend or alter the rules relating to the 35% award limitation and net long position ("NLP") reporting requirements. If an auction cannot be held prior to 2:00 p.m., the Association would recommend automatically postponing the auction until the next business day.

b. Allow primary dealers to bid via back-up sites, overseas offices and telephone

Even if a Primary Dealer is affected by a disruption event, it may still be able to participate in an auction if permitted to submit bids through its back-up sites or overseas offices, either electronically or via telephone. Treasury and FRBNY should therefore encourage Primary Dealers to test periodically the bidding capability of their back-up sites and to train their overseas offices to submit bids via telephone and/or electronically. To ensure readiness in the event of a disaster, Primary Dealers should periodically be encouraged to submit certain bids electronically from their secondary sites. For example, Primary Dealer secondary sites could test their submission capabilities by submitting a test bid at the beginning of certain auctions.

In those instances where electronic submission is not feasible, Treasury and the FRBNY should encourage the Primary Dealers to submit bids directly via telephone, whether from their main sites, back-up sites or overseas offices.¹⁰

c. Expand contingency planning to cover a broader range of possible disruption events

Treasury is to be commended for developing a comprehensive list of possible circumstances that might lead to the disruption of a scheduled auction and the most likely Treasury response. We would, however, encourage Treasury to expand its list to include a broader range of potential events. Because Treasury has specifically asked for feedback on: (i) whether its list covers a broad enough range of possible situations, (ii) the appropriateness of the proposed responses, (iii) the likely market reaction (both immediate and long-term) to Treasury's proposed actions, and the impact (if any) on auction outcomes; we have

⁹Although the Association recognizes that postponing an auction may be necessary in certain emergencies, the Association does not recommend changing the original issuance date of a new note or bill. The maturing cash flow associated with a refunding makes it critical that the original settlement date for a new issue not be postponed.

¹⁰ It is our understanding, however, that few, if any, government securities trading personnel located abroad (i.e. London, Tokyo) are currently authorized to submit bids in the Treasury auction process. Treasury may therefore want to encourage Primary Dealers to expand the list of employees eligible to submit bids on their behalf to include some personnel in overseas offices.

prepared a chart that addresses each of these questions. Because the Association believes that market participants would benefit if Treasury clarified what actions it would take in the face of extraordinary circumstances (natural disaster, terrorist attack, suspension of trading or a disruption to the clearance and settlement system) we have added an entry at the end of the “Contingency” column to address a situation that Treasury’s chart did not discuss.

CONTINGENCY	TREASURY'S PROPOSED RESPONSE/BMA COMMENT	LIKELY MARKET RESPONSE TO A DELAY	IMPACT ON CURRENT/FUTURE AUCTIONS
Treasury/Fed operational/technical problems	Delay auction. Notify market of specific length of delay (e.g. 1-2 hour). ***** The Association supports this proposed response.	Minimal. The WI market would obviously also remain available to those investors that were not comfortable waiting for the rescheduled auction.	Minimal.
Treasury/Fed systems failure	Reschedule auction. Notify market of rescheduling with specific date and time if possible. If not immediately possible, provide follow-up with specific date and time as soon as feasible. ***** The Association supports this proposed response.	Probably minimal. Assuming the auctioned securities are still settled on the originally announced issuance date, the market response is likely to be minimal.	Probably minimal. Depends on Treasury's ability to quickly reassure bidders that the problem will not reoccur.
Bidder connectivity disrupted (some participants affected, auction still covered)	Response will depend on strength of auction coverage. If delay is necessary, then notify market of specific length of delay (e.g. 1 hour). ***** The Association supports this proposed response. However, the Association believes that Treasury should be much clearer exactly what criteria (i.e. a minimal bid to cover ratio or minimum number of dealers affected) it will use to determine whether there was adequate participation in the auction.	It will depend. If most bidders agree with Treasury's decision to redo an auction, the impact is likely to be minimal. Clearly, bidder connectivity problems at one or two dealers should not result in a covered auction being redone. Treasury and the dealer community have engaged in considerable effort this year to test back-up systems and to generally ensure that the Primary Dealers' connectivity via the new TAAPSLink system will not be disrupted. Given these efforts, the majority of Primary Dealers are likely to support a decision by Treasury not to redo a covered auction in most circumstances.	It will depend on whether most market participants agreed with Treasury's decision to redo a covered auction. It is our understanding that those Primary Dealers that lost connectivity could avail themselves of the emergency bidding procedures and try and submit some or all their bids via telephone. Bidders may change their future behavior and submit some of their bids earlier.
Bidder connectivity disrupted (many participants affected, auction not covered)	Delay auction. Notify market of specific length of delay (e.g. 1 hour). ***** The Association supports this proposed response.	Assuming the auctioned securities are still settled on the originally announced issuance date, the market response is likely to be minimal.	Unclear. Depends on Treasury's ability to quickly reassure bidders that the problem will not reoccur.
Independent of connectivity, auction not covered	Delay auction. Notify market of specific length of delay (e.g. 1 hour). ***** The Association supports this proposed response. However, the Association believes that Treasury should clarify the sorts of circumstances that it envisions might result in such a short term delay in an auction.	Unclear. Depends on the particular circumstances. However, assuming the new securities are still auctioned and settled by the originally announced issuance date, the market response is likely to be minimal.	Unclear.
CONTINGENCY	TREASURY'S PROPOSED RESPONSE/BMA COMMENT	LIKELY MARKET RESPONSE TO A DELAY	IMPACT ON CURRENT/FUTURE AUCTIONS

Independent of connectivity, auction not covered due to significant disruption event (natural disaster, terrorist attack, wide spread power outage, war) leading to a suspension of secondary market trading or a disruption to the clearance and settlement system (i.e. many participants affected)	Delay auction. Notify market of specific length of delay (e.g. 24 hours). ***** The Association is recommending that Treasury add this scenario to its contingency plans. In such extraordinary circumstances, we would recommend that Treasury reschedule the auction and immediately notify the market of the rescheduling with specific date and time if possible. If not immediately possible, provide follow-up with specific date and time as soon as feasible.	Minimal. Assuming the new securities are still auctioned and settled by the originally announced issuance date, market participants are likely to be quite understanding and support of a decision to delay an auction. However, the response would be greater if it was a note or bond auction and the auction was cancelled instead of postponed.	Unclear.
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In closing, the Association greatly appreciates this opportunity to comment on Treasury's initiative to develop a primary market contingency plan and would be happy to provide Treasury with further assistance.

If you have any questions regarding this letter, please feel free to contact the undersigned at 646.637.9222 or efoster@bondmarkets.com.

Sincerely,
Eric L. Foster
Vice President
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