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Mr. Fred Pietrangeli, Director
Office of Debt Management
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220
Submitted electronically through Federal eRulemaking Portal: http://www.regulations.gov

Re: **Notice and Request for Information – Development and Potential Issuance of Treasury Floating Rate Notes Indexed to the Secured Overnight Financing Rate (Docket No. TREAS-DO-2020-0007; FR DOC. 2020-11160)**

Dear Mr. Pietrangeli,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to respond to the Department of Treasury's ("Treasury") request for comment to help inform its evaluation of the merits of issuing a floating rate note indexed to the Secured Overnight Financing Rate ("SOFR") published by the SOFR Administrator, currently the Federal Reserve Bank of New York (FRBNY)[2]. Fidelity serves as the investment adviser to a broad array of mutual funds and institutional portfolios that currently invest in Treasury securities and other money market instruments.

I. Executive Summary

Fidelity supports the additional issuance of floating rate notes ("FRNs") by Treasury especially if it provides the investor community with a diversifying reference index. So long as they are appropriately structured, we believe Treasury issued FRNs that are indexed to SOFR ("Treasury SOFR FRNs") could be an attractive investment for Fidelity money market mutual funds, which operate in accordance with rule 2a-7 under the Investment Company Act of 1940 ("Rule 2a-7").[3]

[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 30 million individuals and institutions, as well as through 13,500 financial intermediary firms. Fidelity submits this letter on behalf of Fidelity Management & Research Company LLC, the investment adviser to the Fidelity family of mutual funds.

[2] See Development and Potential Issuance of Treasury Floating Rate Notes Indexed to the Secured Overnight Financing Rate, 85. Fed. Reg. 31282 (May 22, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-05-22/pdf/2020-11160.pdf .

[3] Title 17, Part 270.2a-7 of the Code of Federal Regulations [17 CFR 270.2a-7 Money Market Funds].

Based on our evaluation of Treasury SOFR FRNs as a potential investment, we set forth in this letter our observations and suggestions in response to some of the questions raised by Treasury in its request for information. Our response focuses on three considerations:

- Market Demand – We believe there is sufficient investor demand to support both the 13-Week T-Bill FRN program (without changes) and a new Treasury SOFR FRN program.

- Treasury SOFR FRN Structure – To maximize the demand for Treasury SOFR FRNs, we recommend that these FRNs be structured:
  (i) to represent the current market conditions underlying the reference index as closely as possible with interest rate reset periods that match the reset dates of the underlying index and consider the investment requirements of the largest group of investors;
  (ii) utilizing a one-year final maturity with consistent operationally feasible market-accepted conventions that are standard across asset classes; and
  (iii) with no payment delays and a zero-coupon floor.

- Liquidity – To ensure a high level of liquidity, we recommend that sales of Treasury SOFR FRNs be conducted in the same manner as other Treasury issuances to avoid confusion in the market, but with a mid-month settlement and maturity calendar schedule. As with other Treasury issuances, liquidity will likely be driven by the size of the issuance.

We deal with each of these considerations in more detail below.

II. Market Demand

We believe that an additional Treasury FRN structure, would complement Treasury's existing short-term debt issuance and would further improve the liquidity of their current floating rate notes. Investors would also have a wider and diverse suite of investment options that they may find attractive in different interest rate environments. Accordingly, we would not recommend any changes to the current structure and size of the 13-Week T-Bill FRN program.

We would expect the investor base for Treasury SOFR FRNs to be predominately money market mutual funds, but could also appeal to a broader investment universe, which may include short duration bond funds, short-term retail investors, and other capital markets investors. Treasury SOFR FRNs would also increase the supply of eligible investment products available to money market mutual funds, particularly those funds that have a mandate to invest only in securities issued by the U.S. Treasury.

III. Treasury SOFR FRN Structure

A. Representative of the market conditions underlying the Index

A guiding structuring principle, for FRNs, is for the security to closely track to its underlying reference rate and to avoid features that may lead to deviation between the two. This principle is an important consideration for the development of a properly functioning primary and secondary market for Treasury SOFR FRNs with a daily resetting index (which is currently the only type of market-accepted SOFR reference rate for which the FRBNY has issued a statement of compliance with the applicable IOSCO Principles for Financial Benchmarks).

Security features such as the inclusion of coupons with a backward-shifted observation period and/or the inclusion of coupon lockout periods at the end of interest accrual periods could result in the security deviating from the underlying index. Those structure characteristics may be deemed to be operationally necessary; however, their inclusion may decrease the attractiveness for investors and negatively impact the security's liquidity due to its lack of alignment with the current market conditions reflected by the underlying index. To limit this potential impact, Fidelity recommends a two-day backward-shifted observation period, thus limiting the need for coupon lockout periods at the end of most interest accrual periods and ensuring that for all days -- with the exception of the last interest accrual period -- the security floats as close to current market conditions as much as is operationally feasible. If a market-accepted, forward-looking, term SOFR reference rate develops, we expect that some of the current structural conventions created to ease operational burdens related to the calculation of SOFR, as a daily resetting index, will be significantly reduced.

B. Consider investment requirements of certain significant market participants

When determining the appropriate structure, Treasury should also consider a structure that accommodates money market mutual funds as significant participants. Therefore, Treasury should consider the strictures of Rule 2a-7.

Rule 2a-7 requires a money market mutual fund to maintain a dollar-weighted average portfolio maturity (or, DWAM) that does not exceed 60 days (taking into account certain interest rate adjustments).[4] Because of this, for money market participants, Fidelity generally recommends the shortest possible interest rate reset period which will maximize the ability of such funds to hold larger Treasury SOFR FRN positions. We also recommend that the interest reset periods match the reset dates of the underlying index[5]. If a market-accepted term SOFR reference rate develops, the length of the interest rate reset period (such as daily, weekly or monthly) should also be considered to reduce the impact on a money market mutual fund's DWAM. For example, if a money market mutual fund re-allocates ten percent of its assets from

[4] Rule 2a-7(d)(1)(ii), Rule 2a-7(i).

[5] We note that for securities with a duration or final maturity in excess of 2 years, issuers and bond fund investors would likely consider longer interest rate reset periods (such as quarterly) to be more attractive, as issuers and bond fund investors may desire more certainty of funding (coupon) levels rather than daily sensitivity.

its cash holdings toward the purchase of a FRN with a monthly interest rate reset (roughly every 30 days), then it will add three days (10% x 30 days) to its DWAM at the time of purchase. On the other hand, if the fund allocates ten percent of its assets to an FRN with a quarterly interest rate reset (roughly every 90 days), then it will add nine days to its DWAM (10% x 90 days).

Rule 2a-7 also requires a money market mutual fund to maintain a dollar-weighted average portfolio life (or, WAL) that does not exceed 120 days (***without*** taking into account any interest rate adjustments).[6] In the context of Treasury SOFR FRNs, the shorter the period remaining until final maturity, the less impact the security will have on a money market mutual fund's aggregate WAL calculation. For money market mutual funds, ideally Treasury SOFR FRNs would be structured with a final maximum maturity in the range of one to two years, so that they can readily comply with the Rule 2a-7 WAL restriction. For example, if a money market mutual fund re-allocates ten percent of its assets from its cash holdings toward the purchase of a Treasury SOFR FRN that matures in one year, then it will add 36.5 days (10% x 365 days) to its WAL at the time of purchase. On the other hand, if the fund allocates ten percent of its assets to a Treasury SOFR FRN that matures in two years, then it will add 73 days to its WAL (10% x 730 days).

Although the incorporation of a coupon lockout feature may be operationally necessary at maturity date, in the context of a daily resetting accrual calculation to allow for the calculation and communication of the interest accrual, it does result in the floating rate instrument becoming a fixed rate instrument for the lockout period. While this is not ideal, it is a better outcome (assuming a short lockout period of no more than two days) than the adoption of an interest payment delay beyond the maturity of a security. A lockout period and an interest payment delay both have an impact on the calculation of maturity risk metrics for money market mutual funds, but we believe the adoption of an interest payment delay mechanic is the least attractive option for most investors. Accordingly, we would not recommend the adoption of an interest payment delay convention in any SOFR FRN.

C. Other Considerations

Beyond investment limitation considerations of potential investors, Treasury also may find it beneficial to differentiate the final maturity of their Treasury SOFR FRN offering from their existing 13-Week T-Bill FRN program which currently utilizes a two-year final maturity for its initial offering. By differentiating the original final maturity date, for example with an initial offering of a one-year final maturity for the Treasury's SOFR FRN offering, there is a

[6] Rule 2a-7(d)(1)(iii).

greater likelihood of attracting a deeper and potentially more diverse investor base than what currently exists in the 13-Week T-Bill FRN program today.

Regarding the interest accrual calculation for a daily resetting reference rate, Fidelity recommends that Treasury consider a compounding interest rate accrual calculation. By doing so, Treasury will more closely align their SOFR FRN with the standard market conventions of the derivatives market, which may result in increased liquidity in Treasury's SOFR FRN offering, and ultimately, contribute to the liquidity of SOFR cash and derivatives products more generally. We encourage the issuance of SOFR instruments that use consistent standard market conventions across asset classes and products, to mitigate basis risk for those that hedge their exposure with derivatives, as this will contribute to the development of a deeper more liquid SOFR derivatives market -- a perquisite to the creation of a market-accepted forward-looking term SOFR rate.

We do not believe securities which reference a compounding interest accrual calculation have previously been offered or traded in the short-term money market space. Based on our experience to date, short-term SOFR securities (with maturities of less than two-years) have referenced simple average SOFR. While Fidelity would prefer a Treasury SOFR FRN to reference a compounding interest rate accrual calculation, it may be determined that a daily compounding interest rate accrual product is not operationally feasible[7]. If this is the case and if a simple average accrual structure is used, then Fidelity would recommend that Treasury consider using more frequent coupon payment periods, such as monthly or quarterly, to reduce the accrual difference between a compounding and simple average accrual structure.

In addition, consistent with the structure of Treasury's 13-Week T-Bill FRN, we recommend that Treasury SOFR FRNs be structured with a coupon rate that has a floor of zero to attract potential investors and increase the liquidity of these securities, particularly in times of market stress.

IV. Liquidity Considerations

Fidelity recommends that Treasury conduct sales of Treasury SOFR FRNs in the same manner as that of other auctions of instruments issued by Treasury. Generally, it is important to maintain a certain level of consistency across Treasury issuances, to avoid unnecessary confusion in the market. The existing Dutch auction process used by Treasury will be (1) familiar to investors, (2) establish a reliable schedule, and (3) establish a predictable size range for issuances. Further, Fidelity recommends a similar re-open schedule of an original CUSIP

[7] Fidelity's operating systems would accommodate transactions involving Treasury SOFR FRNs (including those referencing an interest accrual based on Compounded SOFR) and we do not anticipate the need for significant changes in our investment operations.

such that later new issuances may be consolidated under the same CUSIP, which will enable better liquidity to be built within each issue. Similar to other Treasury security issuances, the liquidity of Treasury SOFR FRNs will be driven in large part by the size of the issuance. From a money market mutual fund perspective, larger size issuances provide better liquidity in the product.

To differentiate the Treasury SOFR FRN product from the 13-Week T-Bill FRN program, Fidelity recommends a mid-month settlement and maturity calendar schedule, in addition to a 1-year final maturity discussed above. By doing so, given the potential operational necessity of having to include a backward-shifted observation period and/or coupon lockout period in a Treasury SOFR FRN, Treasury will avoid the potential impact of a month-/quarter-/year-end spike in the SOFR benchmark as a result of a likely increase in volatility in the repo market at a month-/quarter-/ or year-end.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts Treasury undertakes, or respond to questions Treasury may have about our comments.

Sincerely,

Kevin Gaffney
Chief Investment Officer, Money Markets

cc: Alternative Reference Rates Committee - ARRC@ny.frb.org
Attention:
ARRC Chair – Tom Wipf
Floating Rate Notes Working Group Chair: Brian Grabenstein (Wells Fargo)