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Matthew E. Zames
Chief Operating Officer

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The Honorable Jacob Lew
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Mr. Secretary:

Our May 3rd gathering will mark the conclusion of my eight year term of service as a member of the Treasury Borrowing Advisory Committee (TBAC) – including more than four as Chairman. It has been an honor and privilege to have served as an advisor on Treasury debt issuance, helping Treasury to innovate and meet the challenges of funding the government in the lowest cost manner possible. While proud of our accomplishments, I know that we're all in agreement in regretting that no major changes have been adopted to address the most glaring flaw of the government's financing system—the current debt ceiling framework.

Treasury's meeting with this advisory committee dates back to World War II. Treasury meets with TBAC quarterly at the request of the Secretary. TBAC consists of up to 20 Treasury-appointed individuals who are senior leaders employed by primary dealers, institutional investors, and other major financial market participants. The Committee is typically asked to consider the current quarterly refunding operation and to provide expert advice on financing options for the current quarter and on longer term debt management policies.

Although these may sound like mundane, technical policy considerations, the U.S. Treasury market is the most important market in the world. Its orderly operation is critical for financial markets to operate and investors rely on U.S. government securities as a safe haven during uncertain times. Even small changes in rates can result in significant direct costs or savings to taxpayers, and changes in Treasury yields can also influence rates on other financial instruments, impacting investors and consumers around the world.

Of TBAC's many accomplishments, three stand out as being particularly notable during my time on the Committee. First — early in my tenure — the government faced a surge in financing requirements as part of the policy response to the financial crisis. Initially this surge was met in the usual fashion through increased Treasury bill issuance. This rapidly lowered the weighted average maturity (WAM) of the Treasury portfolio to a 20 year low of 49 months. Given tremendous uncertainty around the magnitude and duration of the crisis, prudent risk management regarding the distribution of Treasury's borrowing led to a Committee recommendation to gradually lengthen the portfolio WAM by introducing more long-term issuance. Treasury has been successful in this strategy – the portfolio WAM now stands at 69 months, well above the historical average and close to a 35 year high.

Second, in order to diversify the investor base and satisfy the market's demand for short-dated high quality liquid assets, TBAC recommended the introduction of the Floating Rate Note (FRN), the first new type of Treasury debt security in over 17 years. The first successful auction of the 2-year FRN was held in January 2014 and FRNs have been issued in every subsequent month since. Today there are over $328 billion of FRNs outstanding held by a highly diverse group of investors, demonstrating the success of the product. Broadening the investor base should help to lower borrowing costs and lead to savings for taxpayers.

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Third, in 2014, TBAC advised a change in the debt management framework to hold higher cash balances to mitigate market disruption risks. As such, after studying the issue, Treasury changed its operating framework to hold a prudent minimum level of cash generally sufficient to cover one week of outflows, subject to a minimum balance of ~$150 billion. This was a material change from previous periods when cash balances were targeted to be as close as possible to a $5 billion minimum. This change is common sense when you contrast the U.S. government position with the four largest money-center banks, which each hold on average over $460 billion in high quality liquid assets, much of which is cash at central banks.

While I believe these steps are case studies in good government that result in sound management of the country's finances, they pale in comparison to the potential adverse consequences on Treasury borrowing costs and the health of the broader economy if the government failed to make an interest or principal payment on its debt.

Though both recent debt limit episodes ended with last-minute resolutions that avoided catastrophic technical default, the debt limit framework, which separates passage of legislation that creates the need to borrow from the limit on Treasury's ability to borrow to pay bills already incurred, still remains in place today. Accordingly, the possibility that future debt limit showdowns could introduce market uncertainty and trigger another catastrophic financial crisis still exists and remains the unresolved "elephant in the room." Since 1941 when the Public Debt Act was passed setting a single limit on the amount of Treasury debt obligations that could be outstanding at any one time, Congress has passed and the President has signed more than 80 debt limit increases. It is time to introduce an alternative method of raising the debt limit.

Under current law, the budget decisions that create Treasury's need to borrow are made separately from – and generally earlier than – decisions about the debt limit, thus creating the conditions for disruptive impasses. Though there are many viable policy alternatives to the current dysfunctional debt limit framework, as noted in a July 9, 2015 debt limit report by the General Accounting Office, I think we can all agree with the following principle – it is much more responsible and makes much more sense for Congress to closely link decisions about the debt limit with decisions about spending and revenue at the time that the budget decisions are made and voted upon.

The debt limit should not be seen as a budget tool. It is simply a limit on Treasury's ability to borrow to pay obligations that have already been incurred by Congress during the budget process.

Sincerely,

Matthew E. Zames
Former Chairman and Member
Treasury Borrowing Advisory Committee