



Treasury to Restart 20-Year Bond Issuance

Move may encourage high-quality corporate issuers to follow suit.

May 2020

KEY INSIGHTS

- The U.S. Treasury is set to begin reissuing 20-year bonds. This move will give liability-aware investors an added tool for long-duration hedging portfolios.
- With a benchmark in place, Treasury's move may encourage corporate issuers to follow, raising 20-year credit issuance across the investment-grade spectrum.
- Greater 20-year issuance should improve the ability of plan sponsors to hedge long-dated cash flows, a key element of liability-driven investment strategies.

For the first time in three-and-a-half decades, Treasury will begin issuing 20-year bonds in the first half of 2020.¹ Initial issuance is expected to be USD 10–13 billion, beginning in May 2020, with subsequent offerings in the range of USD 8–10 billion.

With interest rate dynamics very different than they were 30 years ago, Treasury can take advantage of low yields, a flat yield curve, and increased demand for instruments in the 20-year portion of the curve. The move also will give Treasury the option of upsizing issuance to accommodate the unprecedented level of fiscal stimulus aimed at containing the economic damage caused by the coronavirus pandemic.

Corporate Issuers May Follow Treasury's Lead

While such moves have been relatively rare, Treasury's decision to restart issuing 30-year bonds in 2006 provides some historical guidance.² That event also triggered an increase in corporate issuance, as companies across the quality spectrum were able to benchmark their own long-dated offerings to the newly established Treasury issues (Figure 1). We expect a similar reaction this time around.

Who Are the Likely Buyers?

Institutional investors—specifically, defined benefit pension plan sponsors—may be particularly keen to add hedging assets at a point on the curve that currently has relatively limited issuance. Pension plans tend to experience significant interest rate risk as the expected payments due to



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¹ For full details, please see the Treasury's press release on the Web at <https://home.treasury.gov/news/press-releases/sm878>.

² See the Treasury's quarterly refunding statement from August 2005 on the Web at <https://www.treasury.gov/press-center/press-releases/Pages/js2671.aspx>.

Corporate Issuers Followed Treasury's Lead on 30-Year Bonds

(Fig. 1) U.S. Investment-Grade Issuance With 30 Years Left to Maturity

As of	Total Market Value (USD Millions)	% of IG Universe	Average Price	Average Yield	Average Coupon
12/31/2005	35,738	1.8%	100.8	5.82	5.86
Treasury Issuance of 30-Year Bonds Resumes, February 2006					
12/31/2006	74,939	3.8%	101.3	6.16	6.27
12/31/2007	112,986	5.2%	99.9	6.43	6.43

Past performance is not a reliable indicator of future performance.

Source: Bloomberg Index Services Limited (see Additional Disclosure).

High Quality 20-Year Issuance Has Been Scarce and Expensive

(Fig. 2) U.S. IG Issuance With 20 Years Left to Maturity

As of	Total Market Value (USD Millions)	% of IG Universe	Average Price	Average Yield	Average Coupon
12/29/2017	134,070	2.4%	129.6	3.98	6.14
12/31/2018	67,877	1.3%	119.8	4.83	6.38
12/31/2019	103,748	1.6%	131.4	3.65	5.94

Past performance is not a reliable indicator of future performance.

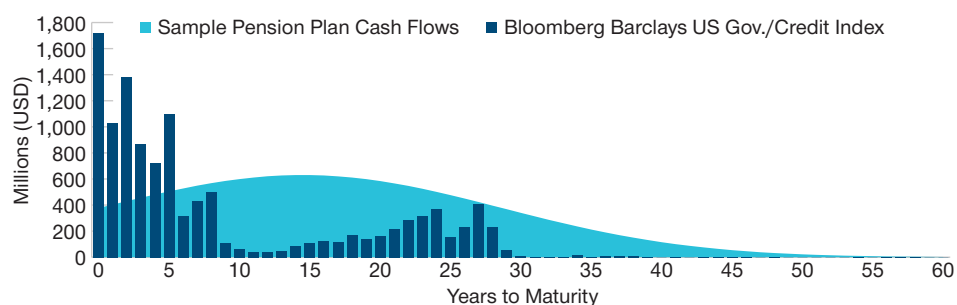
Source: Bloomberg Index Services Limited (see Additional Disclosure).

participants typically stretch many years into the future. To cash flow and/or key-rate duration match these expected payments in a liability-driven investing (LDI) framework, sponsors first must be able to obtain high-quality bonds across the curve.

Whether for individual retirees building a laddered bond portfolio or for plan sponsors attempting to follow an LDI strategy, the limited availability of highly rated securities in the 20-year maturity range currently presents a significant problem. Meanwhile, prices

Increased 20-Year Issuance Should Help Plans Fill Gaps in Hedging Portfolios

(Fig. 3) Sample Pension Plan Cash Flow Mismatch With U.S. Government/Credit Issuance



As of December 31, 2019.

The information presented herein for the Sample Pension Plan is hypothetical in nature and is shown for illustrative, informational purposes only. It is not intended to represent any specific pension plan or cash flow pattern.

Source: Bloomberg Index Services Limited (see Additional Disclosure).

Government/Credit Issues Are Clustered at the Short and Long Ends of the Curve

(Fig. 4) U.S. Government/Credit Issuance by Maturity Bucket

	0–5 Years	5–10 Years	10–15 Years	15–20 Years	20–25 Years	25–30 Years	30+ Years
Number of Issues	3,575	1,826	252	453	606	800	149
% of Market Value	54%	21%	2%	4%	8%	10%	1%

As of December 31, 2019.

Source: Bloomberg Index Services Limited (see Additional Disclosure).

for previously issued bonds with 20 years left to mature come at a steep premium to par (Figure 2). If history were to repeat itself, using the Treasury's 30-year reissuance in 2006 as a guide, we believe the universe of 20-year investment-grade bond issuance could easily double in the coming years.

Applicability to Pension Plans

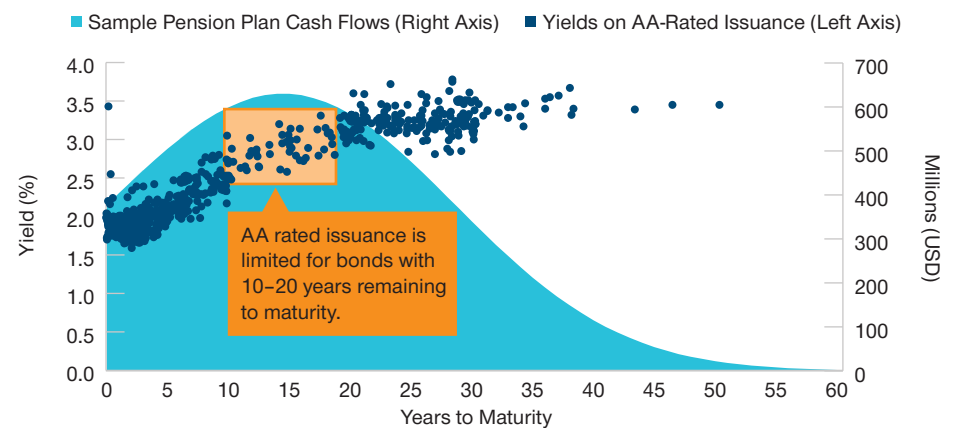
Practically speaking, pension plans often experience liability mismatches at various durations because corporate and government issuance is scarce at these maturities. Generally, this occurs with greater frequency for longer-dated cash flows. With a potential boost in 20-year issuance spurred by the U.S. Treasury, plan sponsors should be able to fill gaps in their hedging portfolios more easily.

Figure 3 shows where a sample plan might experience such mismatches.

Looking at the investable universe of bonds that plan sponsors may consider buying—i.e., highly rated corporate and government securities—we see several large groups of available issues (Figure 4). There is significant issuance of maturities under five years, and then again of bonds maturing in 5–10 years and 25–30 years, respectively. Previously issued 30-year bonds can drift into the 20-year part of the curve as they move closer to maturity, but even so, available issuance there is relatively thin. Following the suspension of 30-year Treasury issuance in October 2001, the absence of long bonds rolling down only enhanced the scarcity of debt in the 20-year range.

A Closer Look at the AA Rated Universe

(Fig. 5) Sample Pension Plan Cash Flows and AA Rated Issuance¹



As of December 31, 2019.

Source: Bloomberg Index Services Limited (see Additional Disclosure).

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¹ Only yields (left axis), not issuance amounts, are shown for AA rated securities.

We examined a subset of the U.S. IG universe, looking specifically at the AA rated credit market. Figure 5 highlights how increased long-duration issuance in that credit segment could help plans following LDI strategies that provide limited budgets for liability-relative tracking error by potentially allowing them to fill gaps in their investment profiles.

Conclusions

- The U.S. Treasury's decision to restart issuance of 20-year bonds should

help institutional investors seeking high-quality long-duration exposures.

- Pension plans stand to be key beneficiaries, as we expect many corporate issuers to follow the Treasury's move, bolstering long-dated issuance across the IG universe.
- Plan sponsors following LDI strategies should be able to utilize the new issuance to fill gaps in their existing hedging portfolios.

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