FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

April 2, 1986

DALLAS, TEXAS 75222

Circular 86-30

TO: The Chief Executive Officer of all depository institutions in the Eleventh Federal Reserve District

SUBJECT

Proposed regulations for Treasury securities held in the commercial book-entry system, which is now designated as the Treasury/Reserve Automated Debt Entry System (TRADES)

DETAILS

The Department of the Treasury is requesting comment on the proposed regulations for Treasury securities held in the commercial book-entry system TRADES. The proposed regulations are intended to provide investors in book-entry Treasury securities with precise procedures by which their interests in those securities can be established and maintained.

ATTACHMENTS

Attached is a copy of the Department of the Treasury's request for comment on the proposed regulations governing TRADES. Comments must be received at the office of the Chief Counsel, Bureau of the Public Debt, E Street Building, Washington, D.C. 20239-0001, on or before May 13, 1986.

MORE INFORMATION

For further information, please contact Tyrone Gholson (214) 651-6263 at the Head Office; Robert W. Schultz (915) 544-4730 at the El Paso Branch; Luke Richards (713) 659-4433 at the Houston Branch; or Tony Valencia (512) 224-2141 at the San Antonio Branch.

Sincerely yours,

William H. Wallace

DEPARTMENT OF THE TREASURY

Fiscal Service

31 CFR Part 357

[Department of the Treasury Circular, Public Debt Series, No. 2-86]

Regulations Governing Book-Entry Treasury Bonds, Notes, and Bills

AGENCY: Bureau of the Public Debt, Fiscal Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Bureau of the Public Debt plans to issue Treasury bonds and Treasury notes only in book-entry form, beginning on or after July 1, 1986. This action will complete the Department's plan, initiated in 1976 with Treasury bills, to offer marketable Treasury securities only in the form of book entries.

The proposed rule, a portion of which is being published below, will, upon final adoption, govern dual book-entry systems covering generally all marketable Treasury securities. Nonmarketable Treasury securities, such as savings bonds, are governed by other regulations found in Subtitle B. Chapter II, Subchapter B of Title 31 of the Code of Federal Regulations.

The part of the rule set out here for comment applies only to securities to be held in the commercial book-entry system, referred to herein as the Treasury/Reserve Automated Debt Entry System ("TRADES"). A separate book-entry system, to be known as the TREASURY DIRECT Book-Entry Securities System ("TREASURY DIRECT"), will be implemented in mid-1986. The proposed rulemaking for TREASURY DIRECT (formerly referred to as T-DAB) was published separately for public comment on December 2, 1985, at 50 FR 49412.

DATE: Comments must be received on or before May 13, 1986.

ADDRESS: Send comments to the Office of the Chief Counsel, Bureau of the Public Debt, E Street Building, Washington, DC 20239-0001.

FOR FURTHER INFORMATION CONTACT: Virginia Rutledge, Attorney-Advisor, (202-535-4890) or Cynthia Reese, Attorney-Advisor, (202-376-4320).

SUPPLEMENTARY INFORMATION: Interested persons are invited to participate in this rulemaking by submitting written comments and suggestions. Those received before the expiration of the comment period will be considered in the preparation of the final rule. No pubic hearing is contemplated, but if written requests for a hearing are received, and if it is determined that the rulemaking process will be clearly enhanced by oral presentation, a hearing will be scheduled.

Discussion of Proposed Rules

Background

Under the authority of Chapter 31 of Title 31 of the United States Code, the Department of the Treasury (the "Department") issues marketable debt obligations of the United States in the form of bills, notes, and bonds ("Treasury securities" or "securities"). In 1967, the Department initiated a system for issuing and maintaining Treasury securities solely by means of entries on the records of a Federal Reserve Bank. The Department also provided that such book-entry securities could be converted into definitive form.[1] Initially, the book-entry system was limited to securities owned by institutions that maintained securities accounts directly on the books of a Federal Reserve Bank. In the early 1970s, the book-entry system was expanded to permit institutions dealing directly with the Federal Reserve to establish aggregate accounts for their customers' securities as well. In this expanded system, ownership of, or security interests in, Treasury book-entry securities could be reflected on the books of entities other than the Federal Reserve Banks; however, issuance and maintenance of the securities at the aggregate level still was handled through the Federal Reserve Banks in their capacity as fiscal agents of the United States.

As a result of the expansion of the book-entry system, Treasury book-entry securities now are held by investors of all types through a vast network of entities that maintain book-entry records of such securities (hereinafter referred to as "book-entry custodians"). Between each ultimate owner of a book-entry security and the Federal Reserve Bank that initially issued such security or currently maintains a record of such security, there may be several intervening book-entry custodians, beginning with a depository institution for whose account the securities are recorded on the books of the Federal Reserve Bank and ending with the book-entry custodian on whose books the interest of the beneficial owner is recorded.

An example will illustrate the tiered nature of the Treasury book-entry system. Assume that an individual ("Individual Investor") has invested in a Treasury 5-year note through a local government securities dealer ("Local Dealer"). Local Dealer will be maintaining one or more Treasury 5-year notes of the same issue through another book-entry custodian such as a larger government securities dealer ("National Dealer"). National Dealer would, most likely, be maintaining the 5-year notes through a bank ("Clearing Bank"). Clearing Bank would be maintaining the 5-year notes directly in an account at a Federal Reserve Bank, assuming that Clearing Bank is an entity that is otherwise authorized to maintain a securities account on the books of the Federal Reserve Bank. Each of the book-entry custodians will record on its books securities maintained for the account of the book-entry custodian below it in the chain, and local dealer will record on its books the interest of Individual Investor.

Because of the speed and efficiency with which transaction involving Treasury book-entry securities can be accomplished, the book-entry system has proven immensely successful. As of December 31, 1985, 97% of all outstanding marketable Treasury securities were held in book-entry form. Since 1978 Treasury bills have been issued in book-entry form only. Beginning in mid-1986, the Department will issue all marketable Treasury securities in book-entry form only. However, bonds and notes issued prior to that date will continue to be convertible to definitive form.

[1] If a security is converted to definitive form, the holder receives an engraved or printed certificate evidencing the debt obligation of the United States.

The book-entry system currently is used for a wide variety of transactions in book-entry securities, from holding Treasury securities solely as a fixed-income investment to the intensive daily trading of Treasury securities in the interdealer market. The Department recognizes that some investors, such as those who purchase Treasury securities for the income stream and who do not intend to trade in the interdealer market, may desire to have a direct relationship with the Department as issuer of the security. As a result, in conjunction with the planned shift to a pure book-entry system, the Department has designed the new book-entry system known as TREASURY DIRECT that will permit investors to hold their securities directly on records of the Bureau of the Public Debt. The existing commercial book-entry system, which can accommodate the intensive daily trading in Treasury book-entry securites of the secondary market, will be retained essentially in its present form.

In anticipation of the change to a pure book-entry system, Treasury has reviewed its existing regulations for book-entry securities (Subpart O of 31 CFR Part 306), which were initially adopted in 1967, and were last amended on June 17, 1974. See 32 FR 15672 (1967); 39 FR 20965 (1974). Particular attention has been given to the rules describing the methods for effectively transferring, and perfecting security interests in, Treasury book-entry securities. Over the past several years, a number of interpretative questions concerning the existing rules have been identified. Treasury believes that it is important that these questions be resolved to help ensure the continued efficiency of the market for government securities and to provide the commercial certainty required by market participants.

Although the current regulations provide a legally sufficient mechanism for transferring and pledging Treasury securities, they are based on a concept, as explanied below, that does not conform to the fact that most transactions involving Treasury securities take place solely by means of computerized book entries. The Department believes that revising its rule to reflect more nearly how transactions take place in the market will simplify transactions in Treasury securities. In addition, these proposed rules should give investors clearer guidelines on how to structure their transactions for maximum safety.

At the time of the adoption of the initial book-entry regulations, virtually every state's commercial law dealing with investment securities anticipated that securities would exist only in definitive form. That law was based upon Articles 8 and 9 of the Uniform Commercial Code. When the Department expanded the book-entry system to permit maintaining book-entry securities on the books of entities other than the Federal Reserve Banks, it concluded that state law should continue to govern, with only slight variations, transactions recorded at levels below the books of the Federal Reserve Banks. As a means of applying those rules, the book-entry regulations currently provide that Treasury book-entry securities be deemed to be maintained in bearer definitive form.

After careful consideration, the Department has concluded that continued use of the bearer definitive fiction in the book-entry regulations is not advisable. The methods of accomplishing transactions involving book-entry and definitive securities are operationally different. Rules for transferring ownership of definitive securities or for perfecting security interests therein are built around the concepts of possession and delivery. Possession is significant in that it is exclusive: only one entity or individual may be in actual possession of a definitive security at any given moment. As a general matter, delivery constitutes the transfer of possession. In contrast, ownership of a book-entry security, or a security interest in such a security, generally depends upon the records of at least one entity other than the beneficial owner. In the example described above, the Individual Investor's record of ownership depends upon entries on the books of the Federal Reserve Bank, the Clearing Bank, the National Dealer, and the Local Dealer.

Given all of the foregoing, the Department believes that the bearer definitive fiction may in some cases cloud the intended relationships between parties to a transaction involving book-entry securities, especially in a secured transaction where book-entry securities are the collateral. Under general legal principles, rights and duties of the secured party and the grantor of the security interest may depend to some extent on who is in possessionof the collateral. Because the concept of possession is not applicable to book-entry securities in quite the same sense as it is with definitive securities, what rights and duties are relevant may be unclear. In part because of these ambiguities, the Department proposes to eliminate use of the bearer definitive fiction. However, to do away with the fiction and leave book-entry securities subject to state law would result in a lack of uniformity in the rules that would govern transactions is such securities.

Since the initial adoption of the Treasury book-entry regulations, Article 8 of the Uniform Commercial Code has been amended to include rules for both certificated and uncertificated, *i.e.*, book-entry, securities. As of January 21, 1986, nineteen states had adopted some variation of the revised Article 8. Given this current state of flux in state commercial law governing uncertificated investment securities, reliance on state law would create a lack of uniformity that would be undesirable given the national scope of the government securities market. Recognizing the need for uniform rules at all levels of the book-entry system, the Department concluded that its own regultions should include all of the basic mechanical rules needed for effectively transferring Treasury book-entry securities and for perfecting security interests therein. In drafting the proposed rule set forth below, a major goal was to generate rules that provide needed clarity and uniformity, but that, to the extent possible, conform to current practice in recording transactions involving book-entry securities, so that the rules would not unnecessarily require operational changes for participants in the government securities market.

Section-by-Section Analysis

Section 357.0. This section establishes that, beginning with the earliest effective date to be specified in § 357.1(b), the Department will maintain two separate book-entry systems for holding securities. TRADES is in essence the same system that exists today (also referred to as the commercial book-entry system). That system is made up of a network of entities, including the Federal Reserve Banks, a variety of financial institutions, and dealers and brokers in government securities, through which investors may maintain or carry out transactions in securities. If a security is maintained in TRADES, as described in § 357.0(a), then there may be one or more tiers of book-entry custodians between a given Federal Reserve Bank and the ultimate owner, in addition to the depository institution in whose account the security is reflected on that Federal Reserve Bank's records. TREASURY DIRECT is a new system that will permit investors to hold securities directly on records of the Bureau of the Public Debt. Proposed rules governing TREASURY DIRECT (formerly referred to as T-DAB) were

published for public comment on December 2, 1985, at 50 FR 49412.

Section 357.1. Section 357.1(a) describes the applicability of the proposed rule both to new issues of securities and to securities already issued and outstanding. With two qualifications, the proposed rules will apply to all transactions in bonds, notes, and bills occurring on or after a specified date. Transactions occurring prior to the specified date will be governed by the existing regulations. The first qualification to the general rule of applicability is that securities will not be eligible to be transferred to or maintained in the new TREASURY DIRECT system unless the offering circular for such security specifies that it is eligible for TREASURY DIRECT or until such time as the Department subsequently may announce its eligibility. The Department plans to phase in applicability of the TREASURY DIRECT system to outstanding issues of bonds and notes at some time after the system has been implemented. Bills issued prior to the specified date for bills will not become eligible for TREASURY DIRECT, but may continue to be maintained either through TRADES or through the existing book-entry system maintained by the Department exclusively for bills. The Department intends to phase out the latter system as bills mature and the new bills that are offered are made eligible for TREASURY DIRECT.

The second qualification to the general applicability rule is that the new rules of Part 357 may not limit or restrict obligations of the United States with respect to any security issued and outstanding prior to the date such security becomes eligible for TREASURY DIRECT. In addition, rights in securities that were acquired under applicable law as in effect before the date specified herein [which is 60 days after the date of publication of this Part in final form] shall not be affected. Under this provision, for example, holders of outstanding securities that contained an option to convert to definitive form will continue to have this option. However, consistent with the Department's goal of shifting to a pure book-entry system, securities offered and issued after dates to be announced by the Secretary will not include such an option.

Section 357.2. This section describes the law which governs the rights and obligations arising out of interests in securities. The rights and obligations of the United States, the Department, and the Federal Reserve Banks in their capacity as fiscal agents of the United States, are governed solely by Federal law. Therefore, obligations of issuers of securities under state law, such as those set forth in Article 8 of the Uniform Commercial Code, will not apply.

The rights and obligations of others with respect to interests in securities shall also be governed by Federal law and any state or local law not inconsistent with such Federal law. For example, state law, such as laws on succession or inheritance, may still be applied, where relevent, in determining rights to specific securities so long as such law is not inconsistent with these regulations and other applicable Federal law. The operation of state law in a case of intestate succession would not be inconsistent with these regulations so long as the application of such law was based initially upon a recognition of ownership by the deceased as reflected on TREASURY DIRECT. Other examples of potentially applicable state law are given in the text of § 357.2.

The section on governing law does not explicity deal with the impact of the rules contained in this Part on transactions in book-entry securities that occur outside the United States. The Department intends these rules to be the exclusive means for voluntary transfers of interests in securities, but recognizes that the rules governing conflicts or choice of laws in other countries may dictate that such other country's own commercial law govern such transactions, especially if the parties to the transaction do not contractually select U.S. Federal law as the governing law. The Department specifically invites comments on the potential for conflict of the proposed rules and foreign law. To the extent that such comments recommend dealing with the issue explicity in § 357.2, the Department invites suggestions as to how such a provisions should be formulated.

Section 357.3. This section contains certain defined terms that are relevant to Subpart B. Additional defined terms were published in § 357.4 in connection with proposed rules relating to TREASURY DIRECT. In the final rule, § 357.4 as originally proposed will be renumbered as § 357.3 and will contain all of the definitions relevant to both Subpart B and Subpart C.

Note that the proposed definitions of "security", "security interest" and "pledge" contained in this proposed rulemaking supplement the proposed definitions initially published in § 357.4 as described above. All other proposed definitions are published for the first time in this proposed rulemaking or simply restate definitions previously proposed.

The only definition that requires some explanation is the definition of "book-entry custodian". As defined, the term includes ony persons that maintain securities accounts for others as part of their ordinary course of business. The rational is to permit only persons with a regularized system of records showing interests of customers in securities to act as book-entry custodians for purposes of these rules. It should be noted that a transaction involving securities will not be effective unless the transaction is reflected in accordance with these rules on the books of a book-entry custodian, as defined in § 357.3, or on the books of a Federal Reserve Bank, whichever is appropriate.

Section 357.10. This section specifies how payments of interest and principal on securities in TRADES will be made. The rule specifies that the payment obligation of the United States is discharged at the time a payment is credited to an account at a Federal Reserve Bank in accordance with the instructions of the holder of the securities. The rule further requires that book-entry custodians make payments received with respect to securities available for use by their customers by the close of business on the day on which the book-entry custodian receives such payment. Similar provisions exist with respect to securities held in TREASURY DIRECT. See 31 CFR 357.26.

Sections 357.11. The proposed rules on rights acquired by a transferee follow similar rules in Article 8 of the Uniform Commercial Code. In connection with this rule, the department has given careful consideration to whether it is feasible or appropriate to include a rule for setting competing claims to the same security where both claimants acquired their interest in the security in good faith and without knowledge of the conflicting claim. As is described in detail below, the inclusion of such a rule raises a number of issues all of which are significant and some of which are particularly important to the continued high level of efficiency of the government securities market.

Because of the complexity created by the various issues raised, the Department has chosen not to include a specific rule for competing claims this time but to leave settlement of such claims to state law. The Department specifically invites comments as to all of the issues raised and the various alternative approaches to competing claims that are discussed below. Furthermore, the Department welcomes suggestions of a specific rule for settlement of competing claims that might be adopted in these regulations in

place of applicable state law. Any such suggestions should, if possible, include both implementing language and detailed consideration of the effect of the suggested approach on all aspects of the government securities market.

The Department has considered three different approaches to the question of competing claims. Before discussing these approaches, it may be helpful to illustrate how conflicting claims to securities may arise in a tiered book-entry system. Essentially, competing claims may be categorized as either vertical or horizontal.

Vertical conflicting interests in securities are claims between two or more of the entities in a chain of accounts.[2] For example, a conflict could arise between a dealer's clearing bank and the dealer's customer when the clearing bank has extended credit to the dealer to finance the dealer's positions in securities and has taken a security interest in securities in the dealer's clearing account as collateral for the loan. Conflicts also can arise between entities further separated in the chain of accounts.

Under current practice, customer securities frequently are segregated [3] from dealer securities that may become subject to the clearing bank lein. If such segregation has not occurred, then the clearing bank's lien may conflict with the claims of the dealer's fully-paid customers.

A different set of competing claims are those that may be viewed as horizontal competing claims. These claims arise not from the interrelationships of entities in a chain of accounts but from some undisclosed defect in the right of a transferor to transfer a security. For example, a transferor ostensibly transferring full ownership of a security might have granted a security interest to a third party. Claims against the security between the secured party and the transferee would, in a sense, be linked horizontally through the transferor that transferred the security in violation of the security interest.

Although there are numerous hypothetical examples that might give rise to competing claims, the circumstances in which competing claims will require resolution probably are limited. Conflicts between vertical claims for the most part will arise only in the event of the insolvency of a book-entry custodian and even then only to the extent that customer securities have not been segregated from securities as to which another entity in the chain has a lien.

Conflicts between horizontal claims also appear to be limited. The probability of horizontal claims of the type described in the example above should be diminished once a security interest is perfected by a transfer of the security interest, as described in § 357.14(b).

In spite of the foregoing, it is clear that some cases will arise that require resolution of competing claims. The Department has considered three different approaches to the problem.

1. The first approach would be to provide a specific rule in these regulations that incorporates the theory of the traditional bona fide purchaser ("BFP") rule into the book-entry system. Under the traditional rule, as between two good faith purchasers of property that are without notice of the other's claim, the last in time to purchase wins by cutting off any prior adverse claim.

There are several problems with incorporating a traditional BFP rule. First, the theory of the BFP rule developed at a time when all securities were issued in physical form and purchasers took delivery of the certificates. As a result, the concept does not translate easily into a system where transfers of securities occur by book-entry. This is the case whether the system is a pure book-entry system, such as TRADES, or a system based on securities issued in physical form that are immobilized at some level in aggregate accounts so that transfers of smaller denominations occur by book-entry. As noted below, the drafters of revised Article 8 declined to adopt a broad BFP rule, and the Department is reluctant to proceed with such a significant deviation from Article 8 without the benefit of comments from market participants.

Second, a BFP rule may give investors at all levels an unwarranted sense of security. The utility of the BFP rule in a book-entry system may be limited by the fact that vertical competing claims of upper-tier book-entry custodians theoretically may attach after the interest of an entity further down the chain of ownership. Since BFP status protects only against prior adverse claims, this raises the question of what, if any, practical value follows from adoption from a BFP provision.

Third adoption of a BFP provision could advesely affect the liquidity of the government securities market. Clearing banks provide daily credit to dealers to assist them in financing their transactions. Such credit extensions are possible only if the regulators of the banks supplying credit are satisfied that such loans are consistent with safety and soundness concerns which in general requires that they be fully collateralized.

It is possible that alterations to the traditional BFP rule could addres some of these concerns. For example, a BFP rule could be fashioned to confer BFP status only with respect to horizontal claimants or vertical claimants.[4]

Although the Department has considered such alternatives, designing rules that conform to the current operational structure of the government securities market would appear to create unworkable levels of complexity. Commentors who favor either a BFP or modified BFP rule are requested to provide specific suggestions on how such a rule would operate.

2. A second alternative would be to establish a rule that favored a particular class of participants in the government securities market without regard for the order in time of the claims in question. Such a rule could be fashioned always to favor lower-tier claims over upper-tier claims or vice versa. Although such a rule would greatly simplify the resolution of competing claims, it appears to be unjustifiably arbitrary. Furthermore, a rule favoring the lower-tier claims could present safety and soundness problems for clearing banks and other upper-tier entities, and thus liquidity problems for dealers, to an even greater extent than was suggested

[2] The term "chain of accounts" includes the Federal Reserve Bank on whose books a security is maintained, the ultimate owner of the security, and the intermediate book-entry custodian or custodians between that Federal Reserve Bank and the ultimate owner. For instance, in the example used to illustrate the tiered nature of the book-entry system near the beginning of the background discussion above, the chain of accounts includes the appropriate Federal Reserve Bank, Clearing Bank, National Dealer, Local Dealer, and Individual Investor. A chain of accounts may include fewer tiers than the example or, in some cases, a greater number of tiers. In addition, a chain of accounts will not necessarily include clearing banks or dealers. It may be made up of financial institutions with other types of interrelationships, such as banks and their correspondent banks.

[3] Segregation, as used in this document, refers to the process of separating on the clearing bank's books securities that have been fully paid for by customers of the dealer from all other securities held by the dealer through the clearing bank. The segregation occurs when, upon instructions from the dealer, securities are moved by the clearing bank from the dealer's general clearing account to a separate account as to which the clearing bank disclaims any liens.

[4] Such a rule could further provide that a purchaser of a government security obtain BFP status after a specified period of time (*e.g.* 24 hours). Such an approach would be predicated on the assumption that after that period of time the securities could be segregated in a customer account as described in footnote 3. While the Department has considered such as alternative, it does not appear to deal satisfactorily with problems associated with the failure to segregate customer securities at all levels in the chain of accounts.

above because the lower tier claims would defeat all claims, not just claims that arose prior in time.

3. The third approach, and the one chosen by the Department, is to permit competing claims to be resolved under state law. The Department recognizes that, like the two alternatives already discussed, this approach has some disadvantages. As already mentioned in the background discussion, current state law on uncertificated securities is in a state of flux. Nineteen states have adopted the 1978 revisions to Article 8 of the Uniform Commercial Code. Because of the limited applicability of the Article 8 BFP rule to uncertificated securities generally, it appears that, where the law of any of these nineteen states is applicable, any vertical or horizontal claim to a security, as described above, always will be subject to prior adverse claims. The only thing that might cut off prior claims would be the purely practical problem, referred to above, that a prior claimant may not be able to trace the security against which it has a claim to a subsequent purchaser. In those states that have not adopted the revised Article 8, it is possible that the traditional BFP rule might be applied to resolve competing claims. As a result, the third approach initially may not achieve an optimum degree of either certainty or uniformity as to the outcome of cases involving competing claims.

Nevertheless, the Department believes that this third approach is the most feasible at this time. Several factors contributed to this decision. Some of the difficulties with attempts to fashion a bona fide purchaser rule that could be applied to a tiered book-entry system have already been described. Furthermore, the Department notes that the drafters or revised Article 8 themselves severely limited applicability of the Artizle 8 BFP rule to uncertificated securities, no doublt in recognition of theoretical and practical difficulties such as those noted here.

From the foregoing discussion concerning competing claims to book-entry securities, it should be apparent that the interests of investors who have fully paid for their securities would be best protected by an enforceable segregation requirement that will assure that such securities will be free of any liens—at least after the close of business on the purchase date. Such a rule would be beyond the scope of the Department's current statutory authority for promulgating regulations governing book-entry securities. The Department has submitted a bill to Congress providing for the regulation of government securities dealers and containing specific rulemaking authority for promulgating a segregation requirement and enforcement it through inspection of books and records. The Department believes that this bill is a necessary step to providing optimal security for the government securities market. Absent adoption of this bill or similar legislation, it appears that no regulatory action can resolve, to the maximum extent possible, the complex questions that arise from either vertical or horizontal competing claims.

Section 357.12. This proposed rule contains two parallel rules for effecting transfers of book-entry securities. Section 357.12(a) provides the rule for effecting transfers on the books of the Federal Reserve Banks. The proposed rule is intended to apply only to transactions among Federal Reserve Banks and entities that otherwise are permitted to maintain a book-entry securities account at a Federal Reserve Bank. The rule applies to all transactions of the books of a Federal Reserve Bank involving one or more such entities including the initial issuance of securities, whether the entity acquired the securities for its own account or for the account of a customer. If the entity acquired the securities for the account of a customer, then § 357.12(b) would apply to entries made on the books of the entity to show the customer's interest. Because subsections (a) and (b) each apply to transfers at different levels in the book-entry system, they are not alternative transfer rules to be applicable depending upon the choice of the parties to a given transaction.

Under §357.12, a transfer of a security is accomplished at the time an entry is made on the books of either a Federal Reserve Bank or a book-entry custodian crediting the security to the securities account maintained for the transferee at such Federal Reserve Bank or book-entry custodian. Making an entry on an entity's books crediting securities to a transferee's account is intended to describe the same action more commonly referred to as "marking the books." The rule is intended to describe an act that is a part of a standardized system of bookkeeping through which a book-entry custodian keeps a record of securities held for specific customers. In keeping with the foregoing, the term "books" as used throughout the proposed rule and the section-by-section analysis, was chosen because it connotes such a system of records. However, it should be clear that the term "books" does not require the presence of tangible objects such as journals and ledgers in order to have an effective transfer since the entire book-entry system is predicated upon the use of computer entries as the means of effecting transactions and storing information. Although the Department does not believe it is feasible to define the relevant act more precisely because of operational differences that may exist in the bookkeeping methods of various book-entry custodians, the Department specifically invites comments on this point and suggestions as to any potential refinements of the relevant phrase.

This type of tranfer can be used for both transfers of ownership and transfers of security interests comparable to pledges of definitive securities. Both types of transactions would be recorded simply as transfers on the relevant entity's books and the entity will view the transferee as the owner. For those transactions in which the transferee is merely a secured party, the nature of the interest being transferred and the relationship between the transferor and the transferee will be set forth in the security agreement that is required under §357.14 below for attachment and perfection of the security interest.

Unlike the similar rule of section 8–313(1)(d) of Article 8, the sending of a confirmation to the transferee under § 357.12 is not a prerequisite to an effective transfer. However, sending confirmation is required as an independent duty of a book-entry custodian under § 357.15(a) below.

There were several considerations that led the Department to structure the rule in this way. It seemed inadvisable to require both book-marking and the sending of confirmation, as in Article 8, because such an approach made the effectiveness of a transfer to a transferee depend upon two separate actions that must be taken by a book-entry custodian, and might therefore increase the risk that an effective transfer would not be accomplished. For example, even if a book-entry custodian's books had been marked to show the transferee's interest, if insolvency of the book-entry custodian intervened so that confirmations were never sent, then there would have been no effective transfer to the transferee. Failure to effect the transfer might have a detrimental effect on the transferee's rights in a liquidation of the book-entry custodian. To allow a transferee's rights to be affected by a fortuity such as whether or not the ministerial act of sending confirmation had been accomplished seems and unreasonable result.

Because book-entry custodians frequently mark their books prior to sending out a confirmation, it seemed appropriate to have a transfer completed at the earliest parcticable time in order to protect the rights of the investor. For these reasons, book-marking was selected as the single event necessary to accomplish an effective transfer. To diminish the risk that a book-entry custodian would not mark its books as required, § 357.15(f) provides that the confirmation constitutes a warranty that the book-entry custodian has in fact marked its books.

An alternative solution would have been to require both book-marking and confirmation but to have the time of effectiveness relate to the time of book-marking. If book marking were the earlier of the two events, then once the confirmation had been sent the transfer would be deemed effective as of the earlier date. Such a rule would temporarily suspend a transferee's rights but would not ultimately delay the time of effectiveness if a confirmation ultimately was sent. Such a rule, however, like the first alternative, makes the transferee's rights depend upon two actions of the book-entry custodian rather than one, and thereby increases the risk that an effective transfer would not be accomplished. For that reason, this alternative was rejected.

A third alternative would have been to have only the confirmation be the prerequisite to an effective transfer. This alternative was rejected both because it might delay the effectiveness of a transfer, as described above, and because it might discourage appropriate record-keeping. In the event of insolvency of a book-entry custodian, the most fundamental evidence of customers' interests in book-entry securities will be that book-entry custodian's own books. As a result, it is the marking of the book-entry custodian's own books. As a result, it is the marking of the book-entry custodian's books that should be the minimum requirement for effecting a transfer.

Based upon all of the foregoing, it was concluded that the best approach would be to make an effective transfer depend solely upon the act of marking the books. At the same time, the Department agrees with the conclusion of the drafters of Article 8 that it is advisable for transferees to receive confirmations so that there is some evidence outside the book-entry custodian's books of the transferee's interest in the security. As a result, issuance of confirmations is set out as an independent requirement for book-entry custodians. Because the use of confirmations appears to be already widely used, the requirment should not add a new burden to commercial practice. In any case, the Department believes that regardless of any legal requirements to issue them, confirmations will be demanded by transferees as a matter of prudent business practice.

As a final matter, consideration has been given to the scope of the transfer rules just discussed. The Department has concluded that the rules should represent the exclusive means for transferring ownership of Treasury book-entry securities. The proposed rule is not, however, intended to supplant creation of equitable interests in securities under established principles, nor would it preclude the creation of interests in book-entry securities by private agreement. However, to have title that is good against third parties, it would be necessary to have an effective transfer under the proposed rules.

Section 357.13. Section 357.13 provides specific methods for transferring a security interest in addition to the pledge-type transfer described above under § 357.12. Note that effecting a transfer under any of the provisions of this section may be only one of the requirements for perfection of the security interest. See § 357.14 below.

It is anticipated that, under §§357.13 (a) and (b), the books of the Federal Reserve Bank or the book-entry custodian will continue to reflect the ownership of the security by the transferor of the security interest, but an added notation would also reflect the identity and interest of the secured party. For example, the securities could be placed in a collateral account that reflects the identity of both the owner and the secured party.

Note that, as specified in § 357.17(a) below, the class of entities that may acquire security interests under § 357.13(a) is limited to Federal Reserve Banks, the United States, entities entitled to recordation of a security interest on the books of a Federal Reserve Bank solely by virtue of an express requirement of Federal law or the order of a Federal court, and entities that have a special agreement with a Federal Reserve Bank for recording security interests. The inclusion of entities that have special arrangements with a Federal Reserve Bank for recording security interests does not create a new method for perfecting security interests in securities nor does it expand the class of entities for which recordation of security interests on the books of a Federal Reserve Bank is available. The proposed rule merely describes current practice under which, in very limited circumstances, individual Federal Reserve Banks will agree to record security interests on such terms and conditions as they deem appropriate, for certain entities, primarily governmental units, that are not otherwise eligible to maintain any accounts with the Federal Reserve Bank.

Sections 357.13 (b) and (c) provide two methods for transferring security interests at levels of the book-entry system below the Federal Reserve Banks. Note that under §§ 357.15 (b) and (c) below a book-entry custodian is required to send and acknowledgment of the transfer to the transferor of the security interest and, under § 357.16(b), to the secured party. Note also that neither § 357.13(b) nor 357.13(c) is applicable if the transferor's book-entry custodian is also the secured party. A special rule is provided in § 357.13(d), as discussed below, for transfers of security interests to a book-entry custodian from its own customer.

The transfer method provided in § 357.13(b) essentially is parallel to the method described in § 357.13(a); the primary difference is the entity on whose books the security interest is recorded. Section 357.13(c) provides an additional method for transferring a security interest that is essentially parallel to the method described in Section 8–313(1)(h)(i) of Article 8 of the Uniform Commercial Code. Unlike the § 357.13(b) method, under § 357.13(c) the parties to a secured transaction can transfer a security interest without depending upon the actions of the book-entry custodian who may be a third party with no direct interest in the transaction. The Department recognizes that permitting the transfer of a security interest solely by means of sending notice to the book-entry custodian on whose books the transferor appears raises several questions. For example, should it be necessary to establish in court that a security interest had been transferred in accordance with § 357.13(c), it would be necessary for the secured party to establish that appropriate notice was actually received by the book-entry custodian. Without cooperation by the book-entry custodian this could prove difficult unless the notification had been hand delivered or delivered by registered mail. Such a proof problem would appear to limit severely the usefulness of such a rule.

An added difficulty is presented by the fact that there is some case law suggesting that a book-entry custodian

has the right to refuse notice under Section 8–313(1)(h)(i). If applied to the similar provision in the Department's regulations, such case law would also appear to limit the utility of the security interest transfer method of § 357.13(c).

Still another set of difficulties arises when the rule is considered from the point of view of a book-entry custodian that might receive notification of a security interest under § 357.13(c). For example, one might ask whether notice to a single branch of a large bank is notice received by a book-entry custodian for purposes of the rule. If so, then the rule would create operational problems for a book-entry custodian since it would be possible to receive notice of a security interest at one office and subsequently receive fraudulent instructions to sell the security at another office. If the book-entry custodian sells the security based on the owner's instructions, should it then be viewed as having violated a duty owed to the secured party? May such a duty be imposed when the book-entry custodian has taken no affirmative action recognizing either the security interest or the secured party?

Clearly, the § 357.13(c) method of transferring a security interest has many questions that were left open by the drafters of Article 8 and have not been resolved by case law. The Department nevertheless has chosen to include the method because it may provide a desirable alternative in some cases that permits transfer, and therefore perfection, of a security interest without the direct involvement of a book-entry custodian. Although such a method of perfection leaves open the risk that a book-entry custodian might transfer inadvertently a security in which a § 357.13(c) security interest has been granted, the Department notes that the same risk is already present under the provisions of § 357.14, which permits automatic perfection of security interests in certain circumstances for a limited period of time without requiring a transfer on the book-entry custodian in accordance with either § 357.12 or 357.13.

Based on the foregoing discussion, comments are specifically requested on the utility and the advisability of including a method of transferring security interests like the one in proposed § 357.13(c).

Section 357.13(d) provides the only method by which a security interest may be transferred to a book-entry custodian from that book-entry custodian's own customer. The Department concluded that a separate rule was appropriate to emphasize that, except for the limited class of transactions covered by § 357.13(d), an effective transfer of a security interest requires the involvement of a third party having no interest in the transaction giving rise to the security interest. In other words, the book-entry custodian marking its books to reflect a security interest under § 357.13(b), or receiving notice of a security interest under § 357.13(c), should be acting solely in its capacity as a custodian and not for its own account.

An added reason for a separate rule is that the transfer methods described in § 357.13(b) and (c) do not necessarily describe any step that operationally would be taken by a book-entry custodian in taking a security interest from its own customer. Since it is clear, however, that a book-entry custodian must be able to take such a security interest, the Department concluded that a separate rule such as § 357.13(d) would avoid any temptation to interpret § 357.13(b) loosely in order to cover a book-entry custodian's security interest. Such a broad interpretation of the concept of book-marking could dilute the idea, emphasized in the discussion of both § 375.3 and 357.12, that book-marking constitutes an act that is part of a standardized system of bookkeeping.

For the foregoing reasons, the Department drafted § 357.13(d) to provide that, for a book-entry custodian taking a security interest in customer securities, the transfer of the security interest occurs at the later of: (1) The time that the security itself is transferred to the customer under § 357.12(b) or (2) the time that a written security agreement is executed by the customer granting the security interest to its book-entry custodian. Note that, as with all secured transactions under these rules, a transfer is only one of the steps relevant to achieving an enforceable long-term security interest.

Section 357.14. Article 8 contains provisions on the creation and perfection of security interests that were formerly included in Article 9. Under Article 8, the concept of attachment of a security interest has been eliminated, *i.e.*, it is not possible to create an unperfected security interest in a security. The proposed rules, however, maintain the distinction between attachment, which is enforceable as between the parties to a security agreement, and perfection, which is good against third parties. This was considered desirable because in certain situations, in order to obtain a perfected security interest, the secured party might be forced to rely on the actions of a book-entry custodian that has an interest in the security adverse to that of the secured party. If a security interest has attached but is unperfected, the secured party will have some avenue of recovery that would not be available if attachment were eliminated as a distinct event. If a security interest is perfected, it shall be perfected for purposes of any relevant state law on priority of security interests, including those rules found in Article 9 of the Uniform Commercial Code.

Article 8 has been criticized for not providing a method of perfection that gives adequate notice of security interests to third parties. However, for a book-entry system, the only method of perfection that would provide adequate notice to the public would appear to be centralized public filing. That method was considered to be unacceptably burdensome in light of the current volume of government securities transactions. Therefore, the proposed rule adopts a rule similar to Article 8 which provides a rule that generally a transfer is a necessary incident to a perfected security interest. However, § 357.14(b) provides for "automatic" perfection for a limited period of time without requiring a transfer.

The automatic perfection described in § 357.14(b) parallels a provision for certificated securities contained in Article 9. It is available to all secured parties and is intended to provide a grace period until the usual steps for perfection take place. However, the 21-day period provided in the Uniform Commercial Code has been shortened to seven days because a shorter period of time should be sufficient, given the rapidity of transactions in government securities. Comments specifically are solicited on the appropriateness of this time period.

It should be noted that the relevant time period is measured in calendar days rather than business days. This approach was chosen because a workable definition of business days did not appear feasible. The seven-day period was chosen with the recognition that it would normally include two nonbusiness days and that for some transactions the seven-day period would end on a nonbusiness day so that the transfer required for continued perfection would have to be accomplished before the end of the period.

Long-term perfection can only be achieved by meeting two additional requirements. First, either a transfer of the security to the secured party in accordance with § 357.12(b) must have occurred or a transfer of the security interest in accordance with § 357.13 must have been accomplished. Second, the security agreement must be written. To meet this requirement, either the

security agreement may have been in writing at the time of attachment or the security agreement may be reduced to writing after attachment. The Department intends that the collateral described in the security agreement may be either a specified security or it may be the securities account itself so that the security interest attaches to any securities in the specified account at the time of attachment. Comments are requested as to the appropriateness of requiring written security agreements as part of the process of perfection, particularly with regard to transactions in which the security that constitutes the collateral is transferred to the secured party under § 357.12(b).

Section 357.15. The proposed rule sets forth several duties of book-entry custodians. Section 357.15(a) provides that a book-entry custodian shall provide a transferee with confirmation of a transfer pursuant to § 357.12(b). The reasons for requiring confirmation have already been discussed in the analysis of § 357.12(b) itself.

The rule further provides in § 357.15(f) that by sending the confirmation, the book-entry custodian: (1) Warrants that either an entry has been made in the book-entry custodian's records, or that such an entry will be made before the book-entry custodian next opens for business, crediting such security to a securities account maintained for the transferee and (2) warrants its own good faith and authority with respect to the transfer. As specified in § 357.15(f), the warranty of good faith and authority includes, but is not limited to, certain warranties that the security described in the confirmation is free of claims of third parties. The warranty concerning claims of or created by the book-entry custodian is expressed in absolute terms since it is intended to cover security interests that the warranting book-entry custodian itself may have granted. The warranty concerning claims of other customers of the book-entry custodian covers claims not created by the book-entry custodian and therefore is limited to claims of which the book-entry custodian has knowledge. For example, security interests that have been transferred pursuant to § 357.13(b) or (c) would be covered by the warranty. The warranty, as expressed in the proposed rule, is based on recognition that where a book-entry custodian transfers a security from Customer A to Customer B, the book-entry custodian is acting only as agent for the two customers and, therefore, appropriately can only warrant as to adverse claims of which it has knowledge.

The imposition of such warranties on book-entry custodians cannot guarantee that the facts so warranted will prove to be the case, nor will they likely improve a transferee's position vis-a-vis the book-entry custodian or its receiver or other legal representative in the event of its insolvency. However, expressly stating the warranties in these regulations should have two beneficial effects. First, it will encourage investors to demand confirmations, even though they are not required for effective transfers. Second, it may instill a greater sense of caution in book-entry custodians that might otherwise fail to keep accurate records of customers' positions as well as their own positions, whether through negligence or wilful action.

Section 357.15(b) requires a book-entry custodian to send acknowledgement of the transfer of a security interest under § 357.13(b) to both the transferor of the security interest and the secured party. Requiring acknowledgment to both parties to the secured transaction is based upon the assumption that if a book-entry custodian formally records a security interest on its records, the secured party, as well as the transferor of the security interest, will have established a customer relationship with the book-entry custodian, whether solely as a result of the secured transaction or as a result of other transactions with or through the book-entry custodian.

Section 357.13(c) requires a book-entry custodian to send acknowledgment of the receipt of notice of the transfer of a security interest in accordance with § 357.13(c). In this case, sending acknowledgment to the secured party is not required since it may be a third party with whom the book-entry custodian has no formal customer relationship and receipt of notice of a security interest under § 357.13(c), standing alone, is not a sufficient basis for imposing that relationship.

Section 357.15(d) requires a book-entry custodian to provide to a customer, or a third person designated by the customer, upon written request, information as to all interests of any customers of the book-entry custodian in a security in which the requesting customer has an interest as shown on the books of that book-entry custodian. For purposes of this section, a customer may be either the owner of a security or a person having a security interest in such security that is reflected in the book-entry custodian's books in accordance with § 357.13(b). The book-entry custodian must also identify security interests for which it has received notice in accordance with Section 357.13(c), and any security interest in favor of or granted by the book-entry custodian. Furthermore, § 357.15(g) provides that by providing information described in § 357.14(d), a book-entry custodian warrants the accuracy of all the information provided. This provision and the accompanying warranty provide a mechanism for investors or third parties designated by an investor to verify the investor's interest in a security and the existence of any other interests in a security of which the book-entry custodian has knowledge.

Section 357.15(e) provides that any confirmation or acknowledgment issued pursuant to § 357.15 must be in writing or in a form reducible to writing at the option of the recipient. Such a formulation is intended to permit electronic confirmation messages which may be printed in hard copy if the recipient so chooses. The rule is not intended to cover voice transmissions that are recorded.

Section 357.16. The proposed rule would provide that certain security interests in book-entry securities granted to the Department or to the United States shall have priority over any other security interest in such securities regardless of when such other security interest was created or perfected. The proposed rule restates, in a somewhat more limited fashion, the priority rule that currently is stated in § 306.118(a) of the existing regulations. Many security interests granted to the United States protect the public because they secure deposits that represent tax and other monies owed to the United States. Super-priority for such security interests is considered appropriate because the security interests run to the benefit of the general public rather than to a private entity or even to a single governmental entity. For similar reasons, the proposed rule also provides that securities transferred to the United States or the Department, acting in a governmental capacity, shall be free of all adverse claims.

Section 357.17. Section 357.17(a) makes clear, as described above in the analysis of § 357.13, that the recordation of security interests on the books of the Federal Reserve Banks is available only in limited circumstances. The rule is intended to cover the current practice of placing securities in an account designated as a collateral account in which the interests of both the owner of the security and the secured party are noted and the security may be moved out of the account only upon receipt of instructions from both parties.

Section 357.17(b) replaces a more broadly worded provision in the existing regulations that states, in effect, that transfers or pledges of book-entry securities on the books of the Federal Reserve Banks have priority over any transfer or pledge effected or perfected on the book of a book-entry custodian other than a Federal Reserve Bank. Although the intended effect of both the existing regulation and the proposed rule are similar, the existing rule is overbroad and confusing.

The first sentence of § 375.17(b) is similar to the rule found in Section 8–207(1) of Article 8 that provides that the issuer is entitled to treat the person shown on its books as the person exclusively entitled to exercise the rights and powers of ownership. Under the proposed rule, the Department and the Federal Reserve Banks are entitled to rely exclusively on the books of the Federal Reserve Banks and treat the entity appearing as the holder of a given security on a Federal Reserve Bank's books as the person entitled to transfer the securities or security interests therein or to receive payments of principal and interest. The rule is only intended to address the rights of the United States, the Department, and the Federal Reserve Banks and not to express any determination of the rights of an entity to book-entry securities as against any other third party.

Sections 357.40–375.45. Except as described below, these sections are restatements of proposed rules already published in connection with the proposed rules relating to TREASURY DIRECT. Section 357.42, as originally published, has been deleted because the preservation of existing rights is now dealt with in § 357.1(a), as proposed herein. Section 357.43 as originally published has been renumbered as § 357.42 and is supplemented by a separation into paragraphs (a) and (b) and by the addition of the second sentence in paragraph (b). Sections 357.44 as originally published has been renumbered as § 357.43.

Section 357.44 as set forth below is new. It simply provides that notices arising from judicial proceedings concerning disposition of securities should be directed to the Federal Reserve Bank or the book-entry custodian on whose books appears the interest in such security of the person that the judicial proceedings are directed against. The Department believes that the proposed rule describes what would be the appropriate step in any case since the specified entity is the only entity on whose books a transfer of the security may occur.

Procedural Requirements

The proposed rule is not considered a "major rule" for purposes of Executive Order 12291. A regulatory impact analysis, therefore, is not required.

Although this rule is being issued in proposed form to secure the benefit of public comment, the notice and public procedures of the Administrative Procedure Act are inapplicable, pursuant to 5 U.S.C. 553(a)(2). As no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601, *et seq.*) do not apply.

List of Subjects in 31 CFR Part 357

Electronic funds transfer, Federal Reserve System, Government securities.

Dated: March 7, 1986.

Gerald Murphy,

Fiscal Assistant Secretary.

A new Part 357 is proposed to be added to subchapter B of Title 31, Code of Federal Regulations, Chapter II, and issued as Department of the Treasury Circular, Public Debt Series No. 2–86, to read as follows:

PART 357—REGULATIONS GOVERNING BOOK-ENTRY TREASURY BONDS, NOTES AND BILLS (DEPARTMENT OF THE TREASURY CIRCULAR, PUBLIC DEBT SERIES NO. 2–86)

Subpart A—General Information

Sec.

Subpart B—Treasury/Reserve Automated Debt Entry System (TRADES)

Subpart D—Additional Provisions

Authority: 31 U.S.C. Chapter 31; 12 U.S.C. 391

Subpart A—General Information

§ 357.0 Dual book-entry systems.

Securities to which this Part applies, as set forth in § 357.1, shall be maintained in either of the following two book-entry systems, and may be transferred from one system to the other in accordance with this Part:

(a) *Treasury/Reserve Automated Debt Entry System (TRADES).* A security is maintained in TRADES if it is credited to a securities account maintained at a Federal Reserve Bank. *See* Subpart B for rules pertaining to TRADES.

(b) *TREASURY DIRECT Book-entry Securities System (TREASURY DIRECT).* A security is maintained in TREASURY DIRECT if it credited to a TREASURY DIRECT account as described in § 357.20.[1] (See Subpart C for rules pertaining to TREASURY DIRECT.)

§ 357.1 Applicability.

(a) This Part applies to all transactions in securities in book-entry form that occur on or after [the date which is 60 calendar days after the date of publication of this Part in final form], except that:

(1) A security may not be transferred to or maintained in TREASURY DIRECT unless the offering circular applicable to such security specifies that it is eligible to be maintained in TREASURY DIRECT or until such time as the Secretary announces that such security has become eligible to be maintained in TREASURY DIRECT; and

(2) Nothing contained in the rules set forth in this Part shall limit or restrict existing obligations of the United States with respect to any security issued and outstanding prior to the date such security becomes eligible to the maintained in TREASURY DIRECT. In addition, these rules shall not affect the rights the parties have acquired in a transaction in such outstanding securities that occurred prior to [the date which is 60 calendar days after the date of publication of this part in final form] and that was rightful and effective

[1] TREASURY DIRECT accounts will be maintained through a system administered by the Federal Reserve Bank of Philadelphia, acting as fiscal agent of the United States. Such accounts may be accessed by investors in accordance with Subpart C through any Federal Reserve Bank or the Bureau of Public Debt.

under the regulations and law then applicable to such outstanding security.

(b) A transaction involving a transfer of a security or a security interest will be deemed to have occurred for purposes of this section on the date on which occurs the act that constitutes a transfer of a security or of a security interest as described in this Part.

(c) This part supplements, amends, and modifies the regulations contained in Department Circular No. 30, current revision (31 CFR Part 306) and Department Circular, Public Debt Series No. 26–76 (31 CFR Part 350), and to the extent that the rules contained in this Part are inconsistent with the regulations contained in Circular Nos. 300 and 26–76, the rules of this Part shall control, subject only to the limitation set forth in paragraph (a)(2) of this section.

§ 357.2 Governing law.

The rights and obligations of the United States and the Department with respect to securities to which this Part applies are governed solely by applicable Treasury regulations, including the regulations of this Part, the offering circular, the announcement and/or notice of the offering, and other applicable Federal law (hereinafter collectively referred to as "applicable Federal law"). The rights and obligations arising out of interests in securities, other than rights and obligations of the United States, are governed by applicable Federal law, and, to the extent not inconsistent with such applicable Federal law, by state and local law. For example, determinations as to what constitutes a valid security agreement or what rights a secured party shall have upon default should be determined in accordance with state or local law.

§ 357.3 Definitions.

In this Part, unless the context indicates otherwise:

"Bill" means an obligation of the United States, with a term of not more than one year, issued at a discount, under Chapter 31 of Title 31 of the United States Code, in book-entry form.

"Bond" means an obligation of the United States, with a term of more than ten years, issued under Chapter 31 of Title 31 of the United States Code, in book-entry form.

"Book-entry custodian" is a person other than the Department or a Federal Reserve Bank, that in the ordinary course of its business maintains book-entry securities accounts for other persons. A book-entry custodian may have a security interest in securities held for another person and also may hold securities for its own account.

"Department" means the United States Department of the Treasury and, where appropriate, the Federal Reserve Banks acting as fiscal agents of the United States.

"Entity" means any person except an individual.

"Federal Reserve Bank" or "Reserve Bank" means a Federal Reserve Bank or Branch.

"Note" means an obligation of the United States, with a term of at least one year, but of not more than ten years, issued under Chapter 31 of Title 31 of the United States Code, in book-entry form.

"Person" means and includes an individual, corporation, company, association, firm, partnership, trust, estate, and any other similar organization.

"Secured party" is a person in whose favor there is security interest.

"Security" means a bond, note, or bill, each as defined above in this section, and any other obligation issued by the Department that, by the terms of the applicable offering circular, are made subject to this Part. Solely for purposes of this Part, it also means the interest and principal components of a security eligible for Separate Trading of Registered Interest and Principal of Securities ("STRIPS"), if such security has been divided into such components by the express terms of the offering circular under which the security was issued and the components are maintained separately on the books of a Federal Reserve Bank.

"Security agreement" means an agreement that creates or provides for a security interest.

"Security interest" and "pledge" mean an interest in a security, which interest is acquired by a secured party to secure payment or performance of an obligation and is created by a security agreement between the person having such obligation and the secured party.

Subpart B—Treasury/Reserve Automated Debt Entry System (TRADES)

§ 357.10 Payment of interest; payment at maturity or upon call.

(a) Interest on securities maintained in TRADES shall be credited through a Federal Reserve Bank to such reserve or other account at a Federal Reserve Bank as is designated by the entity to whose securities account such securities have been credited. See § 357.26 for the rules governing payments with respect to securities held in TREASURY DIRECT.

(b) Securities maintained in TRADES shall be redeemed at maturity or upon call by charging the securities account in which they are maintained and by crediting the amount of the redemption proceeds, including both principal and interest, where applicable, through a Federal Reserve Bank to such reserve or other account at a Federal Reserve Bank as is designated by the entity to whose securities account such securities have been credited. See § 357.26 for the rules governing payments with respect to securities held in TREASURY DIRECT.

(c) The obligation of the Department and the United States to make payments of interest and principal on securities held in TRADES shall be discharged at the time payment in the appropriate amount is credited to an account at a Federal Reserve Bank as described in paragraph (a) and (b) of this section in accordance with the instructions of the entity to whose securities account such securities have been credited. See also § 357.26(b)(1)(iii).

(d) A book-entry custodian that is maintaining securities on behalf of another person shall, upon receipt of any payment in accordance with § 357.10 (a) or (b) relating to such securities, make such payment available for withdrawal or use by such other person at the earliest possible time on such date of receipt and in any event not later than the close of business on such date of receipt.

§ 357.11 Rights acquired upon transfer, attachment and perfection.

(a) Upon transfer of a security in accordance with § 357.12, the transferee acquires the rights in the security that the transferor had or had actual authority to convey.

(b) Upon the attachment or perfection of a security interest in accordance with § 357.14, the secured party acquires rights only to the extent of the interest transferred and to the extent described in § 357.14. The creation or termination of a security interest constitutes a transfer of a security interest.

§ 357.12 Transfers of securities.

Transfer of a security to a transferee occurs only:

(a) At the time an entry is made on Federal Reserve Bank books that credits such security to a securities account maintained for the transferee; or

(b) At the time an entry is made on the books of a book-entry custodian that credits such security to a securities account maintained for the transferee.

§ 357.13 Transfers of security interests.

Transfer of a security interest to a secured party occurs only:

(a) At the time an entry is made on the books of the Federal Reserve Bank on

whose books the interest of the transferor appears identifying such security interest in favor of the secured party; or

(b) At the time an entry is made on the books of the book-entry custodian on whose books the interest of the transferor appears identifying such security interest in favor of the secured party, which cannot be the book-entry custodian making the entry; or

(c) At the time written notification of the security interest is received by the book-entry custodian on whose books the interest of the transferor appears, which book-entry custodian cannot be the secured party. Such notification must be signed by the transferor of the security interest, which in the case of a termination of a security interest in accordance with § 357.14(d), or in the case of an assignment of a security interest, is the secured party; or

(d) If the secured party is to be the book-entry custodian on whose books the interest of the transferor of the security interest appears, at the later of (1) the time the security is transferred to the transferor of the security interest in accordance with § 357.12(b), or (2) the time the transferor has executed a written security agreement with the book-entry custodian granting the book-entry custodian such security interest.

§ 357.14 Enforceability, attachment, perfection and termination of a security interest.

(a) A security interest attaches to a security, and is enforceable between the grantor of the security interest and the secured party, only if—

(1) The security interest has been granted pursuant to a security agreement between the grantor of the security interest and the secured party,

(2) The grantor of the security interest has rights in the security, and

(3) The secured party has given value.

The time at which a security interest attaches shall be the time at which the last of the above conditions for attachment has occurred.

(b) A security interest becomes perfected and enforceable against third parties for a period of seven (7) calendar days from the date on which it has attached under paragraph (a) of this section. Thereafter, a security interest will continue to be perfected only if, no later than the seventh day of the period described above, (1) the security interest has been transferred to the secured party pursuant to § 357.13 or the security has been transferred to the secured party pursuant to § 357.12 and (2) the security agreement referred to in paragraph (a)(1) of this section has been reduced to written form signed by the grantor of the security interest and containing a description of the collateral. In the event that the requirements described in paragraphs (b) (1) and (2) of this section have not been met within the seven-day period, the security interest will become unperfected and unenforceable against third parties until the time at which both requirements have been complied with, and the security interest will be deemed to be perfected only as of such time.

(c) A security interest that is perfected in accordance with this section shall be perfected for all purposes, including but not limited to the applicability of any state or local law concerning priority of perfected security interests.

(d) A security interest in a security is terminated by (1) transfer of the security to the grantor of the security interest, a designee of the grantor, or any successor in interest of the grantor, or (2) written release of the security interest signed by the secured party.

§ 357.15 Duties and warranties of book-entry custodians.

(a) A book-entry custodian shall send confirmation of a transfer of a security under § 357.12(b) to the transferee no later than the close of business on its next business day after the day on which the entry is made on the books of the book-entry custodian that credits such security to a securities account maintained for the transferee.

(b) A book-entry custodian shall send an acknowledgement of the transfer of a security interest in accordance with § 357.13(b) above both to the transferor and to the secured party by the close of business on its next business day after the day on which an entry is made on the books of the book-entry custodian identifying such security interest in favor of such secured party.

(c) A book-entry custodian shall send an acknowledgement of receipt of notice of the transfer of a security interest in accordance with § 357.13(c) to the transferor of the security interest by the close of business on its next business day after the day on which the book-entry custodian receives such notice.

(d) A book-entry custodian, upon the written request of a customer (as defined below), shall confirm to such customer or a designee of such customer (1) the interest in such security of such customer and any other customer in such security as such interests appear on the books of the book-entry custodian; (2) any security interest for which the book-entry custodian has received a notice in accordance with § 357.13(c); and (3) any security interest in favor of the book-entry custodian, or granted by the book-entry custodian to a third party. For purposes of this paragraph, a customer of a book/entry custodian is any person whose interest in a security, including a security interest, is recorded on the books of the book-entry custodian.

(e) Any confirmation or acknowledgement issued pursuant to this section must be delivered in writing or in other form reducible to writing at the option of the recipient of such confirmation or acknowledgment.

(f) By sending a confirmation in accordance with paragraph (a) of this section, a book-entry custodian (1) warrants to its transferee and any subsequent transferee that the book-entry custodian has made an entry in its books crediting the security described in the confirmation to a securities account maintained for its transferee, or that such an entry will be made before the book-entry custodian next opens for business; and (2) warrants the book-entry custodian's good faith and authority; such warranty of good faith and authority shall include in particular, but shall not be limited to, (i) a warranty that the security described in the confirmation is free of any and all claims of, or claims created by, the book-entry custodian except as specifically noted on the confirmation; and (ii) a warranty that, to the knowledge of the book-entry custodian, the security described in the confirmation is free of claims, except as specifically noted on the confirmation;

(g) By sending a confirmation in accordance with paragraph (d) of this section, a book-entry custodian warrants to its customer that the information provided therein is accurate.

§ 357.16 Priority of interests of the United States.

A security interest in securities transferred to the United States or the Department to secure deposits of public money, deposits to Treasury tax and loan accounts, or any other security interest in favor of the United States that is required by Federal statute or regulation and is transferred to the United Sates or the Department, shall be superior to any other interest created in such securities, whenever created. A security transferred to the United States or the Department shall be free of any adverse claims, whenever created, unless the security was acquired in a transaction in which the United States or the Department was acting in a proprietary rather than governmental capacity.

§ 357.17 Rights of the United States and Federal Reserve Banks with respect to transfers on Federal Reserve Bank records.

(a) A transfer of a security interest on the books of a Federal Reserve Bank under § 357.13(a) may be made to a person or entity other than a Federal Reserve Bank or the United States only pursuant to an order of a Federal court or a specific requirement of Federal law or by special agreement with the Federal Reserve Bank on whose books the transfer is to be recorded. In the event that a security interest is transferred on the books of a Federal Reserve Bank pursuant to § 357.13(a), that Federal Reserve Bank shall recognize the interest of the secured party only to extent expressly set forth in the applicable Federal statute or regulations, that Federal Reserve Bank's operating circulars and letters or by specific agreement with the secured party.

(b) Except as otherwise provided in paragraph (a) of this section, and notwithstanding any information or notice to the contrary, the United States and the Federal Reserve Banks shall be entitled to treat the entity in whose account a security is credited as the entity exclusively entitled to effect transfers of such security, to receive interest and other payments with respect to such security and otherwise to exercise control over the security. Subject only to any requirements to recognize the interest of a secured party as described in paragraph (a) of this section, a Federal Reserve Bank that has transferred a security or a security interest according to the instruction of the entity in whose account the security is maintained, shall not be liable for conversion or participation in breach of fiduciary duty even though the instructing entity had no right to issue the instruction. The Federal Reserve Bank shall be fully discharged by completing the order of the entity in whose account the security is maintained.

Subpart D—Additional Provisions

§ 357.40 Additional requirements.

In any case or any class of cases arising under these regulations, the Secretary of the Treasury ("Secretary") may require such additional evidence and a bond of indemnity, with or without surely, as may in the judgment of the Secretary be necessary for the protection of the interests of the United States.

§ 357.41 Waiver of regulations.

The Secretary reserves the rights, in the Secretary's discretion, to waive any provision(s) of these regulations in any case or class of cases for the convenience of the United States or in order to relieve any person(s) of unnecessary hardship, if such action is not inconsistent with law, does not impair any existing rights, and the Secretary is satisfied that such action will not subject the United States to any substantial expense or liability.

§ 357.42 Liability of Department and Federal Reserve Banks.

(a) The Department and the Federal Reserve Banks may rely on the information provided in a tender or transaction request form and are not required to verify the information. The Department and the Federal Reserve Banks shall not be liable for any action taken in accordance with the information set out in a tender or transaction request form or evidence submitted in support thereof.

(b) In the event that the United States or the Department is unable to make a payment when due, the liability of the United States and the Department is limited to the amount of the payment. In the event that the United States or the Department is unable to take any other action with respect to securities to which this Part applies, neither the United States nor the Department shall be liable for failure to take such action if such failure to take action is due to an event which is beyond the reasonable control of the United States or the Department. An event which is beyond reasonable control includes but is not limited to natural disasters, acts of God, war or other civil comotion, accident, computer or other equipment failure, or the failure or interruption of electrical power or of communications lines.

§ 357.43 Liability for transfers to and from TREASURY DIRECT.

A depository or sending institution that transfers to, or receives, a security from TREASURY DIRECT is deemed to be acting as agent for its customer and agrees thereby to indemnify the United States and the Federal Reserve Banks from any claim, liability, or loss resulting from the transaction.

§ 357.44 Notices of attachment for securities in TRADES.

In the event of judicial proceedings in which a person seeks to attach a security maintained by a Federal Reserve Bank for an entity's account or to obtain an order concerning disposition of such securities, any notice of attachment or other notice arising from such judicial proceeding shall be directed to the Federal Reserve Bank on whose books such security is maintained. In all other cases in which a person seeks to attach a security maintained in TRADES or to obtain an order concerning disposition of such security, any notice of attachment or other notice arising from such judicial proceeding shall be directed to the book-entry custodian on whose books appears the interest of the person against whom the attachment or other disposition is sought.

§ 357.45 Supplements, amendments or revisions.

The Secretary may, at any time, prescribe additional supplemental, amendatory or revised regulation with respect to securities.

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