

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6718]
April 26, 1971]

Program for Further Expansion of Book-Entry
Procedure for Treasury Securities

*To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

Last December this Bank announced plans by the U.S. Treasury Department and the Federal Reserve Banks for an accelerated program for the further expansion of the book-entry procedure for Treasury securities. Since January 1, 1968, the book-entry procedure has been applicable to Treasury securities owned by a member bank and held for its sole account at a Federal Reserve Bank in lieu of the safekeeping of definitive securities; the procedure has also been applicable to Treasury securities held at a Reserve Bank as collateral for advances by the Reserve Bank or as collateral to Treasury Tax and Loan Accounts and related deposits. Over the years, the book-entry procedure has been expanded to apply to Treasury securities held in custody at Reserve Banks for various other categories of safekeeping accounts, primarily governmental and foreign official accounts. As of the end of 1970, over \$100 billion in Treasury securities were held in book-entry form at the Federal Reserve Banks. The rules and procedures governing book-entry accounts at this Bank are set forth in this Bank's Operating Circular No. 14, "Safekeeping, Handling, and Shipment of Securities," and Operating Circular No. 21, "Book-Entry Treasury Securities."

As indicated in the plans announced last December, in connection with the emergence of a problem of curtailed insurance coverage for Government securities, the present program for the further expansion of the book-entry procedure involves its extension to include Treasury securities held by member banks (a) for account of their customers, including customers which are nonbank primary dealers in Government securities, and (b) as their "dealer" inventory in those cases in which the bank is a primary dealer in Government securities. Since December, the Treasury, the Internal Revenue Service, and the Federal Reserve Banks have adopted several changes in applicable regulations and procedures to facilitate the implementation of that program. The purpose of this circular is to report on such changes, and to advise you of the current status of the program and plans for its further expansion.

In this District, the program has involved two separate steps. The first provides for the extension of the book-entry procedure to Treasury securities held by banks as primary dealers in Government securities or as clearing agents or custodians for nonbank primary dealers and certain other customers, and that are cleared through this Bank's Government Securities Clearing Arrangement. To facilitate this step, the Treasury adopted amendments, effective January 1, 1971, to Subpart O of Treasury Circular No. 300, "General Regulations With Respect to United States Securities" (31 CFR, Part 306), and the Internal Revenue Service adopted changes in the applicable Income Tax Regulations and Revenue Rulings (T.D. 7081, Rev. Rul. 71-15 and Rev. Rul. 71-21, all published in 1971 Internal Revenue Bulletin No. 3 at 16-18). Since December, this Bank has been working with the banks participating in the Clearing Arrangement, as well as the Association of Primary Dealers in U.S. Government Securities, with a view to determining general procedures for establishing the necessary new book-entry accounts and to integrating

such accounts into the Clearing Arrangement. Such procedures have been agreed to, and the extended book-entry procedure is available to the twelve New York City banks participating in the Clearing Arrangement.

The next step in the program will be the extension of the book-entry procedure to securities held by all member banks for account of their customers. In this connection, further changes have recently been made in Subpart O of Treasury Circular No. 300 designed to facilitate the operation of the extended book-entry procedure and its application to securities held by all member banks for account of their customers. Such changes, together with the changes referred to above made by the Treasury and the Internal Revenue Service since last December, are reflected in a new basic revision of Subpart O and its Attachment relating to tax matters. Copies of the revised Subpart O, which became effective on April 7, 1971, together with a new Attachment, are enclosed. The revised documents incorporate or reflect the following changes in the rules applicable to the book-entry procedure:

(1) Provision is made for the extension of the book-entry procedure to securities held by member banks for account of their customers.

(2) New rules are provided governing the transfer of book-entry securities, and the effecting of pledges in such securities, on the books of a member bank or other "book-entry custodian."

(3) Subpart O has been restructured to classify different types of book-entry accounts on the books of a Reserve Bank either as (a) accounts maintained by the Reserve Bank acting solely as fiscal agent of the United States, or as (b) accounts maintained by the Reserve Bank in a "dual capacity," i.e., not only as fiscal agent of the United States, but also in its individual capacity.

(4) The applicable tax rules have been revised (a) to facilitate the extension of the book-entry procedure to securities held by dealers in Government securities; (b) to liberalize the identification requirements applicable to book-entry securities owned by member banks and held for investment purposes; and (c) to establish similar rules for tax identification purposes with respect to book-entry securities held by banks for account of their customers.

The Federal Reserve Banks are now preparing the detailed operating rules necessary to implement the extension of the book-entry procedure to securities held by all member banks for account of their customers generally. It is contemplated that under such rules, it would be possible for every member bank to open an additional book-entry account at its Federal Reserve Bank for customer securities. In general, it is also contemplated that such securities would be held in a single account on the books of the Reserve Bank in the name of the member bank, and that the member bank would maintain the records necessary to distinguish the ownership rights of its individual customers in such securities.

When the operating rules governing the opening of such accounts are completed, they will be published in the applicable operating circulars of the Reserve Banks, which in this District are this Bank's Operating Circulars Nos. 14 and 21. Until such publication, the book-entry procedure for securities held for account of banks will, in general, continue to be limited to the three classes of accounts outlined in the present operating circulars, i.e., securities owned by a bank and held (a) in safekeeping, (b) as collateral for Reserve Bank advances, and (c) as collateral for Treasury Tax and Loan Accounts and related deposits. As indicated above, the principal exception to this relates to the book-entry accounts opened for the member banks participating in the Government Securities Clearing Arrangement; the special procedures applicable to such accounts are governed by special terms and conditions between this Bank and the participating banks.

Pending the completion of the new operating circulars and the extension of the book-entry procedure to securities of customers held at all member banks, technical amendments to this Bank's Operating Circulars Nos. 14 and 21, as well as No. 12, "Advances and Discounts," have been made in order to conform such circulars to the recent changes

in Subpart O relating to the capacity in which this Bank maintains book-entry securities. Such amendments are set forth in the enclosed Supplements, dated April 26, 1971, to such operating circulars.

Until certain legal questions have been resolved in connection with the deposit of Treasury securities held by member banks in trust accounts, it is not contemplated that such trust securities would be deposited in book-entry accounts. Such legal questions are being reviewed; when they are resolved, it is anticipated that the book-entry procedure will be available for securities held in trust accounts.

At this point, the book-entry procedure is applicable only to Treasury securities, pursuant to the provisions of Treasury Circular No. 300. Studies are now in progress to apply book-entry systems to securities issued by U. S. Government agencies and corporations, and it is expected that such systems will be available for such securities at a future date.

We would welcome any comments or suggestions you may have with respect to our program for the further expansion of the book-entry procedure. If you have any such comments or suggestions, or if you have any questions regarding the program, the officers and staff of our Government Bond and Safekeeping Department would be pleased to review them with you.

ALFRED HAYES,
President.