FEDERAL RESERVE BANK
OF NEW YORK
Fiscal Agent of the United States

[Circular No. **10112**
November 28, 1986]

PROPOSED REGULATIONS GOVERNING THE TREASURY COMMERCIAL BOOK-ENTRY SYSTEM ("TRADES")

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

Enclosed is a copy of proposed regulations issued by the Treasury Department to govern U.S. Treasury securities in the commercial book-entry system ("TRADES"), which are expected to be published for comment in the *Federal Register* today. These proposed rules have been revised on the basis of comments received on the original proposal published last March 14.

Please note that the comment period is for 30 days from the date the proposed regulations actually appear in the *Federal Register*. You may call (202) 376-4320 to verify the closing date for the comment period.

All interested parties should submit their comments to:

Office of the Chief Counsel
Bureau of the Public Debt
E Street Building
Washington, D.C. 20239-0001

We would appreciate receiving a copy of any such comments; please send them to Don. N. Ringsmuth, Associate General Counsel of this Bank.

Questions on the regulations may be directed, at this Bank, either to Mr. Ringsmuth (212-720-5007), or to MarySue Sullivan, Assistant Counsel (212-720-5025).

E. GERALD CORRIGAN,
President.

December 2, 1986

To the Addressee:

A copy of the Treasury's book-entry proposal referred to in the enclosed circular (Cir. No. 10112) will be furnished upon request (Tel. No. 212-720-5216).

Circulars Division
FEDERAL RESERVE BANK OF NEW YORK

Encl. Cir. No. 10112

Billing Code 4810-10

DEPARTMENT OF THE TREASURY

FISCAL SERVICE

BUREAU OF THE PUBLIC DEBT

31 CFR PART 357

REGULATIONS GOVERNING BOOK-ENTRY TREASURY

BONDS, NOTES, AND BILLS

(DEPARTMENT OF THE TREASURY

CIRCULAR, PUBLIC DEBT SERIES NO. 2-86)

AGENCY: Bureau of the Public Debt
Fiscal Service
Department of the Treasury

ACTION: Proposed rulemaking

SUMMARY: On March 14, 1986, the Department published a portion of a proposed rule (the "March Rule") that will govern securities held in the commercial book-entry system, now referred to as the Treasury/Reserve Automated Debt Entry System ("TRADES"). 51 FR 8846. A separate book-entry system, known as the TREASURY DIRECT Book-Entry Securities System ("TREASURY DIRECT"), was implemented in mid-1986, and final regulations applicable to securities held in TREASURY DIRECT were published on May 16, 1986. 51 FR 18260.

Upon final adoption, the TRADES regulations, together with the final TREASURY DIRECT regulations, will form Part 357 of Title 31 of the Code of Federal Regulations, which will govern all book-entry marketable Treasury securities.

The section-by-section analysis for the March Rule contained a detailed discussion that raised a number of complex issues and requested specific comments and proposed solutions. Several of the comment letters received contained detailed analyses of the proposed rule that responded to the issues raised and identified additional technical issues that required clarification or refinement of the proposed rule. Given the complexity of the issues raised, several commenters requested that the Department, after revision and incorporation of the comments received, republish the rule in proposed form to provide a second opportunity for public comment. The Department responded with a notice published in August 1986 advising those interested that a revised rule would be published again in proposed form with provision for a thirty-day comment period. 51 FR 29559 (August 19, 1986). The revised proposed rule for securities held in TRADES is set forth below, preceded by a section-by-section discussion of the specific comments received, changes made in response to those comments, and, where appropriate, reasons for not adopting suggested changes.

Certain of the provisions set forth below in Subpart A and Subpart D were published in final form as part of the final rule

for TREASURY DIRECT. They are reprinted here for clarity and completeness. Where revisions are proposed, they are explained below in the section-by-section discussion.

DATE: Comments must be received on or before [30 days after publication in the FEDERAL REGISTER].

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, Senior Attorney and Special Assistant, (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. At the option of the Department, those received after the expiration of the comment period may be considered in the preparation of the final rule. No public 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 THE COMMENTS RECEIVED:

SUMMARY

The Department received 28 comment letters on the proposed rule, as published on March 14, 1986. The comments ranged from brief letters simply supporting the project of replacing the existing book-entry regulations (Subpart O of 31 CFR Part 306 and 31 CFR Part 350, hereinafter collectively referred to as "Subpart O") to very detailed letters that included discussions of numerous issues and proposed specific regulatory language to resolve them. The Department thanks all of those who submitted comments and is especially appreciative of the time and effort that went into the more detailed letters.

The majority of comments were favorable, either explicitly or implicitly. Ten comment letters expressly supported the proposed rule, although most suggested modifications of varying degrees. Fifteen other commenters proposed modifications or expressed concerns about specific provisions of the proposed rule but did not oppose its adoption. One bank that submitted a comment letter suggested that the proposed rule was unnecessary but specifically expressed concern only about the requirement of the March Rule to send written confirmation of transfers. Two commenters in a joint letter expressed opposition to the proposed rule and suggested retention of Subpart O with only a single

modification.*/ The Department believes that most if not all of the concerns raised by these commenters have been addressed by the revision set forth below, which includes a number of the suggested modifications.

Not surprisingly, several of the comment letters, including all of the most detailed ones, dealt at some length with the issue of resolution of competing claims that was discussed in detail in the section-by-section analysis of the March Rule. Most of the letters mentioning the issue favored a uniform Federal rule. The more detailed comments, almost without exception, favored adoption of some form of a bona fide purchaser rule and some form of priority for clearing liens. In the revised proposed rule printed below, the Department has adopted this approach.

In addition, several commenters focused on the warranties and duties of book-entry custodians set forth in the March Rule. Some commenters suggested broadening the warranties and including warranties of transferors other than book-entry custodians. In contrast, several banks suggested that, given the rather stringent banking regulations governing custody of customer securities, banks should not be required to make any warranties

*/ In a joint letter, four commenters, including the two referred to above, opposed the adoption of the March Rule, as proposed, but differed in their suggested modifications and submitted individual letters setting out their proposals. As a result, the joint letter has not been counted separately here, although it is included in the total of 28 comment letters mentioned above.

under the Treasury regulations. The bank commenters also pointed out certain differences between the banking regulations, which set out specific rules governing the provision of confirmations of securities transactions to bank customers, and the requirements set out in the proposed rule.

A third area focused on by commenters was the mechanics of the transfer rules themselves. Several commenters proposed eliminating the distinction between rules governing transfers of ownership of whole securities and transfers of security interests. Various reformulations were proposed, although all still would focus on book-marking as the relevant act of transfer. Related comments questioned the need for the additional rules governing attachment and perfection of security interests that were included in the March Rule.

One final area of comment involved the interaction of the regulations with other law. Three commenters specifically suggested that book-entry custodians subject to foreign law be exempt from the Department's regulations. Other comments focused on the interaction between the regulations and State law in a number of specific areas.

Two commenters submitting a joint comment letter questioned the Department's authority to promulgate rules such as those set forth below. Section 3121 of Title 31 of the United States Code grants the Secretary broad authority to establish the terms and

conditions on which Treasury securities are issued. The Supreme Court recognized the breadth of this authority in Free v. Bland, 369 U.S. 663 (1962), in which the Court concluded that Treasury regulations governing ownership of savings bonds validly preempted community property rights in the bonds that might otherwise have existed under State law. The Secretary's authority also supports establishing rules such as those set forth below describing how to transfer interests in book-entry Treasury securities.

A primary concern of these two commenters was that the proposed rule would require significant changes in the current structure of clearing arrangements for Treasury securities. This was not the intention of the Department, and the Department believes that the concerns underlying this comment have been eliminated for the most part by the revisions to the March Rule that are set forth below.

SECTION-BY-SECTION DISCUSSION

Section 357.1.*/ This section provides that the new rule will apply to securities transactions occurring on or after a

*/ Because of the addition of some new sections, certain of the sections contained in the March Rule have been renumbered. Unless otherwise indicated, section numbers in this discussion refer to the sections as numbered below. Where appropriate for clarity, the section number preceding the discussion of comments and changes to any given section is followed by a bracketed number indicating the section number or numbers of the same provision as published in the March Rule.

specified date, which is anticipated to be 60 days after the date of publication of the rule in final form.

Two commenters requested clarification as to how the rule describing the date of applicability of the proposed rule would be applied to a repurchase agreement that is initiated before the effective date but completed after that date. To clarify this point, one of the commenters suggested changing the word "transactions" in Section 357.1(a) to the word "transfers." This would make clear that, for repurchase agreements initiated before the effective date but completed afterward, Subpart O would be applicable to the first step in the repurchase transaction while the proposed rule would be applicable to the second step.

Aside from the issue of how the section should be applied to repurchase agreements, the suggested drafting change would not be consistent with the basic structure of the proposed rule. As used in the March Rule, the term "transactions" was intended to include more than transfers of interests in securities. Both payments of interest and payments of principal on redemption constitute transactions that are to be expressly covered by the proposed rule and for which the effective date of Section 357.1 would be relevant.

Nevertheless, for transactions involving two or more transfers of a security or a limited interest in a security, the Department believes that the result described above will be the

appropriate one as a general rule: each transfer should be viewed separately for purposes of determining the applicability of these regulations. At the same time, the Department recognizes that having a single transaction subject to different rules depending upon the timing of each step in the transaction in some cases may cause unnecessary complexity. Furthermore, for transactions such as secured loans that will be initiated before but will continue beyond the effective date of this rule, the Department recognizes that the parties to such a transaction may wish to have the entire transaction governed by this rule.

To provide flexibility for such transactions, the Department has added a new sentence to Section 357.1(b) that permits selection of either the existing regulations or the new Part 357. The provision requires an agreement in writing and applies only to transactions that will bridge the effective date specified in Section 357.1(a).

The March Rule provided that a transaction involving a transfer would be deemed to have occurred for purposes of this section on the date on which occurs the act that constitutes a transfer as described in this Part. One commenter suggested that if Section 357.1(b) were intended to describe when a transaction occurs for all purposes of the proposed rules, then Section 357.1(b) should state that a transaction occurs "at the time" of transfer rather than on the date of transfer, since several transfers of a security can occur on a single day. The

Department has not adopted this change since Section 357.1(b) was intended to have the limited purpose of describing when a transaction occurs for purposes of the effective date set forth in Section 357.1(a). The Department has added wording to Section 357.1(b) to clarify this point.

Section 357.2. This section is the basic governing law provision. The March Rule provided that the rights and obligations of the United States would be governed by applicable Federal law. The rights and obligations of others would be governed by applicable Federal law, and to the extent not inconsistent with Federal law, by State and local law.

As noted above, questions as to the interaction of these rules with State law arose in connection with several comments. For example, one commenter suggested that, in proposing a rule on the transfer and pledge of Treasury securities, the Department should be cautious about creating rules resulting in different consequences for holding Treasury securities than would be the case for other uncertificated securities governed solely by State law. In particular, this commenter suggested that it would be unwise to ignore existing State law on secured transactions which represent the working out of relative rights of parties to a transaction.

The Department agrees that, as a general proposition, caution should be exercised in varying or preempting State law.

However, the Department notes that the existing regulations of Subpart O already preempt State law to some extent. Furthermore, even with the minimalist approach of Subpart O, which leaves many issues completely to State law, a variety of interpretative questions have arisen concerning the appropriate application of the existing regulations, although not all of these questions have become the subject of litigation. As a result, with respect to book-entry securities, there is not an accepted body of principles that operates to provide predictable results. Matters are further complicated because not all states have adopted the rules found in the 1978 revision to Article 8 of the Uniform Commercial Code (the "UCC"). Furthermore, even where such rules have been adopted, some of the litigation arising from recent failures of government securities dealers suggests that important legal issues are yet to be resolved that stem from some of the concepts and relationships that arise where interests in securities are transferred without the transfer of a certificate. Finally, the Department notes that the law of secured lending generally has continued to change as new types of property that may be the subject of secured transactions have developed, and the balance of rights among the various parties is reexamined and reevaluated. Recent litigation concerning transactions in government securities reflects just such a process.

Given the foregoing, the Department continues to believe that the Federal interest in uniformity and certainty for participants in the government securitites market warrants

supplanting State law with a Federal rule governing transactions in Treasury book-entry securities. In drafting the proposed rule, the Department has not attempted to vary arbitrarily the State law rules governing transactions in investment securities. Instead, the Department's goal is to also provide a rational set of rules that balances the interests of all participants in the market and provides a framework for giving effect to investor expectations while preserving the efficiency and liquidity of the market. The comments received have been very useful in identifying those areas where the March Rule failed to achieve these goals, most notably in the area of competing claims. The Department believes the revisions to the rule published below resolve those deficiencies.

Another commenter suggested an approach that would view the Federal Reserve Banks as clearing corporations, as defined in Section 8-102(3) of the UCC. This approach would also deem all book-entry securities either to be held in bearer definitive form at the Federal Reserve Bank of New York or to be in uncertificated form registered in the name of the Federal Reserve Bank of New York, so that the UCC as adopted by New York would govern all transfers and pledges of securities. This approach has the advantage of providing uniformity and perhaps a reasonable level of certainty throughout the market. However, the Department does not believe that it is appropriate for the entire market in Treasury securities to be subject to the laws of a single State's jurisdiction.

Instead, the Department continues to believe that it is appropriate to provide in its rule the basic framework for transactions in government securities. Under the March Rule, the conceptual approach of the governing law provision was that of a partial preemption of State law: issues not explicitly dealt with in the proposed rules would be governed by State law. After further consideration, the Department has concluded that the difficulty in describing with any precision the line between preempted and nonpreempted State law under such a partial preemption would unnecessarily focus attention on drawing that line. To emphasize the Federal interest motivating the rule, and given the broad authority of the Department to promulgate regulations relating to Treasury securities, the Department has concluded that a better approach is to preempt State law completely. The Department anticipates that, in accordance with the approach taken by the Supreme Court decision in U.S. v. Kimbell Foods, 440 U.S. 715 (1979), principles derived from State law will be incorporated into applicable Federal law as the rule for decision, whenever appropriate, for issues not explicitly dealt with in the regulations. The Department believes that this approach will, on balance, cause less confusion because it focuses on inclusion rather than exclusion, as would be the case with a partial preemption.

One comment noted certain specific areas in existing law that had not been covered in the March Rule. They are the warranties, if any, of issuers of instructions (Section 8-306 of

the UCC); the effect, if any, of unauthorized instructions (Section 8-311 of the UCC); a purchaser's rights, if any, to proof of a transferor's authority (Section 8-316 of the UCC); and the formal requisites, if any, of transfers (Section 8-319 of the UCC).

Two of these would appear to be generally inapplicable in the context of TRADES. Under Section 8-308(4) of the UCC, an "instruction" is defined as an order to the issuer of an uncertificated security, requesting the registration of a transfer, pledge, or release from pledge. The warranties of an originator of an instruction under Section 8-306 of the UCC run to the issuer, to any person guaranteeing the instruction or specially guaranteeing the originator's signature, to a purchaser for value, and to a debtor or third person under certain circumstances. Under Section 8-311 of the UCC, an owner may assert the ineffectiveness of an unauthorized instruction against the issuer and certain purchasers, and an issuer who registers a transfer, pledge, or release of an uncertificated security upon an unauthorized instruction is subject to liability for improper registration.

In TRADES, book-entry securities are transferred electronically on the books of Federal Reserve Banks and in many cases on the books of the book-entry custodians that comprise the system. Transfers on TRADES do not constitute registration for purposes of Article 8 of the UCC, and an "instruction," as that

term is used in the UCC, does not correspond to any procedure now used in TRADES. It is more comparable to a "transaction request" used to request a transfer of a security in TREASURY DIRECT (see Section 357.28). Thus, the Department believes that provisions relating to an "instruction" are inapplicable to securities held in TRADES. To the extent the general principles underlying these sections are relevant, the Department anticipates that they would be applied as the rule for decision by a court, in accordance with Kimbell Foods.

Section 8-316 of the UCC provides that the transferor of a security must supply the purchaser with proof of the transferor's authority to sell. Failure to comply gives the purchaser the right to reject or rescind the transfer. Section 8-319 of the UCC provides that a contract for the sale of securities is not enforceable unless there is some writing signed by the party against whom enforcement is sought, or unless other specified criteria are met. The Department believes that it is inappropriate to promulgate a specific Federal rule in these regulations, since neither of these provisions is suited to the speed with which transactions frequently occur in the government securities market.

Interaction of the proposed rule with foreign law was another issue addressed by commenters. Two commenters suggested that, to avoid subjecting them to potentially conflicting legal requirements, overseas book-entry custodians should be exempt

from the proposed rule unless the book-entry custodian and its customer have made a valid choice of United States law or the law of any state. Their proposed solution would have added language of exemption to Section 357.2 as proposed in the March Rule and would have added a definition of "overseas book-entry custodian" to Section 357.3.

Although the Department agrees with the basic concept, a different solution was chosen that does not require defining a new category of book-entry custodian. Instead, a new Section 357.2(c) simply provides that rights and obligations, other than rights and obligations of the United States, arising out of interests in securities maintained on the books of a book-entry custodian at a place outside the United States are governed by the foreign law applicable to the business of the book-entry custodian, unless the book-entry custodian and its customer have made a valid choice of United States law.

The Department believes this formulation reaches the same results as those intended by the proposals of the two commenters on this issue, but avoids some of the issues that might arise unnecessarily by defining a separate category of book-entry custodians. For example, under the language proposed by one commenter a book-entry custodian that qualified as an overseas book-entry custodian and operated a custodial business in the United States arguably could have claimed exemption from the regulations even with respect to the U.S. custodial business by

virtue of qualification as an overseas book-entry custodian.

In addition, one commenter suggested adding specific language providing that a branch of a domestic corporation may qualify as an overseas book-entry custodian, although technically a branch is not a legal entity separate from the U.S. corporation. Under the Department's formulation, a single entity may conduct custodial business both within and without the United States. Whether or not these rules apply with respect to any specific security would depend upon where the records are maintained and what law is applicable to the custodial arrangement in question.

Finally, one commenter proposed adding language permitting an overseas book-entry custodian to maintain back-up records or computing facilities in the United States provided that the custodial activities of the book-entry custodian generally fell within the description of activities that would qualify an entity as an overseas book-entry custodian. The Department agrees that, standing alone, maintenance of back-up records in the United States should not affect the exemption for securities maintained outside the United States, but does not believe it necessary to add specific language to Section 357.2. In the individual case, whether the level of activity conducted in the United States or the degree of reliance on facilities or records maintained in the United States is sufficient to defeat the exemption, will be a question of fact that may be determined by whether the specific

arrangement in question was reasonable under the circumstances and whether it had the appearance of simply intending to circumvent the applicability of the regulations..

Another commenter suggested the addition of a sentence to Section 357.2 that would have expressly permitted parties to a transaction in a security to make a choice of the law of any State or nation which bears a reasonable relation to the transaction. The ability to make a choice of foreign law bearing a reasonable relationship to a transaction is implicit in the proposed rule for securities maintained outside the United States. However, the Department does not believe that an entity conducting its custodial business in the United States should be able to select foreign law in lieu of the proposed rule. The question of making a choice of applicable State law is no longer relevant because of the preemption of State law described above. The Department does anticipate that the parties to a transaction may select the State law that may be incorporated into applicable Federal law as the rule for decision.

Section 357.3. This section includes all of the defined terms for purposes of Part 357, including definitions already published in final form in the final TREASURY DIRECT rule. 51 FR 18260. Certain new definitions have been added, and certain definitions previously published have been revised. The additions and revisions are described below.

The definitions of "clearing bank," "clearing lien," and "clearing services" are new and are explained in the discussion of Section 357.15, a new provision dealing with clearing liens. The definition of "depository institution" previously included in the TREASURY DIRECT rule has also been included below because of its applicability in the context of the new Section 357.15.

The term "issue" is defined to mean securities identified by a single CUSIP number. A CUSIP number is the number assigned to identify securities of the same issue by the Committee on Uniform Securities Identification Practices. The term "issue" is used in two new provisions, Sections 357.12(c) and 357.14(e).

This manner of defining an issue applies to securities of the same interest rate and maturity that generally are issued on a single day, as well as the principal and interest components separated under the Department's STRIPS program. Whether or not a security is eligible for STRIPS is determined by the offering circular for that security. If a security is stripped, each component is given a different CUSIP number. Interest payments stripped from securities of different maturities but which are due on the same day will bear the same CUSIP number and are indistinguishable from one another. Therefore, once stripped, the interest payments due on the same date are treated, for purposes of this rule, as a single issue.

The definition of "person" has been revised to include

governmental entities.

The definition of "security" has been expanded to provide specifically that a book-entry Treasury security is a security for purposes of State and local law. This clarification was made in response to comments that indicated that a book-entry security might otherwise be considered an "intangible" for some purposes, which could create unpredictable legal consequences. The clarification also is important for purposes of the incorporation of State law principles discussed under Section 357.2 above. The provision is not intended, however, to subject the United States or the Federal Reserve Banks, when acting as fiscal agents of the United States, to the obligations of an issuer under Article 8 of the UCC as adopted by the various states.

The March Rule defined a "book-entry custodian" as a person other than the Department or a Federal Reserve Bank that in the the ordinary course of its business maintains book-entry securities accounts for others. The definition also specifically provided that a book-entry custodian could have a security interest in securities held for another person and also could hold securities for its own account.

A comment was made proposing that the definition of "book-entry custodian" be expanded to state specifically that the book-entry custodian may be the transferor of the security or security interest, because the usual meaning of the term

"custodian" is an independent third party. This proposal may have also been prompted by the discussion of Section 357.13(d) in the section-by-section analysis of the March Rule, which suggested in another context that an effective transfer of a security interest would require the involvement of a third party having no interest in the transaction giving rise to the security interest.

The Department does not believe that an amendment of the definition of "book-entry custodian" is necessary. However, it should be emphasized that, notwithstanding any statement to the contrary in the discussion of the March Rule, under the proposed rule an entity may be both the book-entry custodian and the transferor of a security or a limited interest. The Department recognizes that many repurchase agreements are structured in precisely this way. Although a greater degree of protection may be gained by using a third-party custodian for such transactions, the parties are not required to do so under these regulations.

In response to a suggestion in the comments, the Department considered adding definitions of the terms "transferor" and "transferee," but concluded that the meaning of these terms is sufficiently clear in the context of the rule.

Several commenters proposed additional defined terms in connection with new regulatory language they had proposed. Exclusion of these proposed definitions for the most part

depended upon the Department's response to the underlying issue, as discussed elsewhere in this section-by-section analysis.

Section 357.10. This section describes the procedure by which interest and principal are paid and provides that the obligation of the United States is discharged at the time payment is credited to an account at a Federal Reserve Bank. It also provides that a book-entry custodian, upon receipt of a payment for a customer, must make the payment available to the customer on the date of receipt.

One Federal Reserve Bank noted that the time frame specified for making payments available might be difficult to comply with because the mechanics of crediting such payments may involve end-of-day batch processing. It is the Department's understanding, however, that depository institutions consider the funds available at the beginning of the day even where the actual paperwork regarding the credit may not be completed until the end of the day. The Department believes this is the correct view and notes that no depository institutions or other entities that might be affected by the rule made a similar comment. No change to the rule was made.

Section 357.10(d) has been modified to make the duty of a book-entry custodian to make principal and interest payments available to a customer subject to any rights the book-entry custodian may have as a secured party under a written security

agreement. The original provision was not intended to override any claim that the book-entry custodian might have to such payments arising from an express agreement with a customer.

Section 357.11. Section 357.11 is modeled after the shelter rule of Section 8-301 of Article 8. It describes the rights of a transferee upon acquisition of a security or a limited interest in a security. One commenter suggested that this rule be amended to make clear that the reference to "transferor" includes both the prior interest holder and the book-entry custodian effecting the transfer. The rationale is that a transferee should succeed to the rights that its own book-entry custodian has against any upper-tier custodian. This would appear to be internally inconsistent. In our view, there are two mutually exclusive alternatives: either the book-entry custodian is acting as a principal in the transaction and, therefore, is the prior interest holder, or the book-entry custodian is acting as an agent, in which case it has no rights in the security independent of the rights of its customer.

Another commenter suggested a substantial revision of Section 357.11 as part of its approach to reintroduction of the concept of a bona fide purchaser. A major feature of this commenter's proposal was to rely on State law to determine the consequences of a transfer. This commenter felt that the "shelter rule" as stated in proposed Section 357.11, absent a bona fide purchaser rule, would have the substantive effect of creating a

set of Federal rights, and proposed changing the language to provide that a transfer would be an effective transfer for purposes of State law. The Department has not adopted this change since it follows from the discussion of Section 357.2 that these rules are, in fact, the basis for a set of Federal rights.

One commenter also suggested that it would be useful to clarify that, upon default of the debtor, a disposition of collateral by a secured party conveys to the purchaser all of the debtor's rights in the collateral, as is provided in Section 9-504(4) of the UCC. The commenter was concerned that the interaction of Section 357.2 of the March Rule, which provided that State law would be not applicable where it would be inconsistent with these regulations, with the ideas expressed in Section 357.11 might be viewed as precluding the result dictated by Section 9-504(4) of the UCC. The question of inconsistency has been eliminated by the changes to Section 357.2 discussed above. Furthermore, were the question to arise in litigation it is for just such an issue that the Department anticipates a court would look to State law to supply the rule for decision.

Section 357.12 [Sections 357.12 and 357.13]. The March Rule covered transfers of securities in Section 357.12 and transfers of security interests in Section 357.13. A transfer of a security was deemed to occur at the time an entry is made on the books of a Federal Reserve Bank or a book-entry custodian. Transfer of a security interest was deemed to occur (i) at the

time an entry is made on the books of a Federal Reserve Bank or a book-entry custodian; (ii) at the time written notification is received by a book-entry custodian; or (iii) where the secured party is to be the book-entry custodian, when the security is received in an account for the transferor of the security interest and a written agreement is executed.

Several commenters indicated that they believed the proposed rule made an unnecessary distinction between transfers of ownership and transfers of security interests, and that the correct characterization of a transaction should be left to other law. It was pointed out that a single transaction may be subject to different characterizations for different purposes. This is especially true for repurchase agreements and reverse repurchase agreements, which constitute a substantial portion of the daily activity in the government securities market. One commenter also suggested that the transfer provisions in the March Rule might require modification of the back office procedures to give full recognition in account titles and records to pledges of securities. The proposed solution suggested by some commenters was to combine into a single provision the rules for transfers of securities and transfers of limited interests in securities.

In drafting the proposed rule, the Department did not intend to require new procedures on the part of book-entry custodians. Instead, the Department drafted provisions that conformed to existing practices in various parts of the market. By providing

alternative methods of transfer, the Department believes it provided sufficient flexibility so that no single entity would be required to significantly restructure its operations. In addition, the Department recognized the importance of variable characterization described above and intended to permit parties to accomplish a repurchase transaction without necessarily characterizing it as either an outright sale and repurchase or as a secured transaction. The flexibility to do this was preserved by explicitly recognizing in the proposed rule that a transfer that may appear on the books of a book-entry custodian to be a transfer of outright ownership may also serve as merely a transfer of a security interest. Since repurchase agreements customarily contain language that constitutes a sale and repurchase as well as alternative language describing the grant of a security interest, it would have been possible under the proposed rule to take the position either that the transaction was a sale and repurchase or that it was the grant of a perfected security interest.

Given the number of comments on the point that the Department received, the Department decided to make certain changes that will more clearly preserve flexibility. However, the Department was reluctant to go quite as far as the drafting solutions proposed by two of the commenters that would have completely combined within a single descriptive phrase transfers of ownership of securities and transfers of limited interests. The Department felt that although a certain flexibility should be

preserved, the rule should not encourage intentional ambiguity. Therefore, instead of using a single descriptive phrase, the Department chose to combine Sections 357.12 and 357.13 as originally proposed into a single new Section 357.12 that is structured in a manner similar to Section 8-313 of the UCC. In addition, the Department has substituted the term "limited interest" for the term "security interest" in recognizing that there are a whole range of limited interests in property other than security interests. Under the new Section 357.12, certain of the transfer methods may apply to both transfers of securities and transfers of limited interests while others, by their terms, are confined to transfers of limited interests. The Department felt that although a certain flexibility should be preserved, the rule should not encourage intentional ambiguity.

Two commenters also suggested that what constitutes a transfer should not be limited to the single act of crediting a securities account. The commenters suggested that any entry that permits identification of an interest in favor of the transferee should be sufficient to constitute a transfer. The Department agrees with this approach and has adopted language similar to that suggested in the comment letters.

Another commenter also suggested changing the word "books" to "records" in the proposed rule to avoid an implication that a transfer cannot occur until end-of-the-day reconciliation of a book-entry custodian's books. The Department believes that any

such implication is eliminated by the change discussed in the preceding paragraph.

Two commenters also recommended that the use of subaccounts be specifically authorized as a means of accomplishing a transfer since the computer programs of several clearing banks are structured to permit their use. We understand that what happens operationally is that a dealer may effect a transfer to its customer by directing the dealer's clearing bank to move designated securities into a subaccount of the dealer's account on the books of the clearing bank that specifically identifies the dealer's customer as the transferee. The Department believes that it is not necessary to add specific language referring to subaccounts since the transaction as described falls within the terms of the general transfer rule. However, the Department notes that the use of subaccounts raises an interpretative issue with potentially significant consequences for the dealer and its clearing bank that would not be resolved by adding proposed language explicitly authorizing the use of subaccounts. The basic question is who is acting as the book-entry custodian for the customer? Since the entry reflecting the transfer may be made on clearing bank's books rather than on internal records of the dealer, arguably the clearing bank may be the book-entry custodian for the dealer's customer and would therefore be subject to the provisions setting forth book-entry custodian warranties and other duties with respect to the transfer to that customer. However, it is unlikely that this reflects the

expectations of either the clearing bank, the customer, or the dealer.

An implicit assumption of the transfer rules and the rules describing the duties and warranties of book-entry custodians has been that a transfer is recorded on the books of the entity with whom the transferee deals and that will maintain the security for the transferee, whether or not, between the transferee and that entity, their dealings are expressly characterized as involving a custodial arrangement. Under this view, if a dealer engages in a repurchase transaction with another entity where the dealer retains control of the security, then the dealer would constitute a book-entry custodian for purposes of these rules.

To take into account the assumption just described and to avoid a result that would view the clearing bank in the hypothetical described above as the book-entry custodian for the dealer's customer, the proper view is that subaccounts within a dealer's account on the books of the clearing bank should be viewed as constituting part of the dealer's records as well as a part of the records of the clearing bank. Under this view, the use of a subaccount clearly falls within the general description of a transfer, and it is the dealer that must carry out the duties and warranties of a book-entry custodian with respect to that transfer. It should also be noted that a subaccount transfer may constitute a segregation of customer securities that, in accordance with new Section 357.15(c), prevents

assertion of a clearing lien unless expressly agreed to by the dealer's customer.

One commenter pointed out that in some circumstances a book-entry custodian taking a security interest from its customer might agree that the security interest would not arise until fulfillment of some condition in addition to the requirements set forth in Section 357.12(a)(5). To provide for such situations, the Department has added new language as Section 357.12(b) which permits delayed effectiveness of a limited interest by agreement between the parties.

Several commenters expressed concern in a variety of ways that the March Rule suggested that a book-entry custodian could make an effective transfer simply by marking its books and without regard to whether that custodian actually maintained any of the appropriate securities itself either directly on the books of a Federal Reserve Bank or through another book-entry custodian. The March Rule had been structured as it was in part to express the idea that at all times after a book-entry custodian marks its books in favor of a customer, that customer has rights as against its book-entry custodian to the amount of securities so transferred to the customer regardless of the specific time at which the book-entry custodian itself may have acquired such securities. However, in light of the comments received, the Department has reconsidered this issue and concluded that, although the underlying assumption is correct,

the March Rule may have appeared to have an impact different from that intended. Therefore, the Department decided to include regulatory language expressing the need for a link between ownership reflected on the books of a book-entry custodian and maintenance of securities at a Federal Reserve Bank. This required link is what was described in the March Rule as a "chain of accounts." 51 FR 8849, n.2.

Two commenters proposed similar definitions of "written" that describe what means of recording data will constitute an entry for purposes of the transfer rules. The Department has incorporated the definitional language into Section 357.12(d) as a means of describing when an entry is made. The Department concluded that the concept of a writing was unnecessary so long as guidance is provided as to what may constitute an entry. However, the Department did not include the phrases suggested by these commenters that would have required that the data not only be displayable at some point in time, but that it be expected to be stored. This requirement seemed to incorporate into the rules what would more appropriately be simply an evidentiary issue in the event of litigation.

Section 357.12(e) is a new provision describing cross-system transfers between TREASURY DIRECT and TRADES.

Several commenters suggested that the notice-type security interest provided in Section 357.13(c) of the March Rule be

eliminated, primarily because of the uncertainties as to the rights and obligations that would exist between the book-entry custodian and the secured party that were described in the discussion of the March Rule. It was also pointed out that retaining Section 357.13(c) would have the effect of transforming TRADES into a paper system. Some of these commenters proposed in the alternative that the rule explicitly provide that a book-entry custodian may reject any such notice of a security interest. Since no commenter suggested that the notice-type security interest would constitute a particularly useful alternative to the other methods of transferring security interests, the Department decided simply to eliminate the notice-type security interest.

Section 357.13 [Section 357.14]. This section sets out the rules for enforceability of a security interest between the grantor and the secured party and the enforceability of a security interest against third parties. It also covers the termination of a security interest.

As noted above, several commenters recommended minimizing the distinction between transfers of securities and transfers of security interests and other limited interests in securities. As a corollary to this suggestion, some of these commenters also recommended eliminating virtually all distinctions between attachment, perfection, and transfer of a security interest. In addition, some commenters noted that the terms "grant",

"creation" and "validity" of a security interest are also used in other provisions of the proposed rule, and suggested that these terms created unnecessary confusion.

Although admittedly there is some overlap in some of the terms referred to above, in drafting the proposed rule the term was used that seemed best suited to the context. It was felt that since all of them have been terms used in the area of secured lending, their meaning would be relatively clear.

One commenter also noted a source of confusion in that Section 357.1(b) of the March Rule appeared to make the transfer of a security interest the pivotal event. As already explained in the discussion of another comment on Section 357.1(b), that provision is significant only for purposes of determining the applicability of these rules to a transaction in a security that was outstanding prior to the adoption of this rule in final form.

Two of the commenters suggested alternative approaches to Section 357.14 of the March Rule that would eliminate the concept of attachment. The Department included attachment as a separate concept in the March Rule for two reasons. First, the Department felt that the three requirements of attachment, none of which is extraordinary, should not be eliminated as basic prerequisites for carving out a security interest from the bundle of rights and interests belonging to an owner of property. The Department

believes that it is precisely in the case of secured transactions that many of the uncertainties under Subpart O have arisen. In drafting the proposed rule, one of the Department's primary goals was to eliminate that uncertainty. It seemed advisable, whenever possible, to cast the proposed rule in terms of concepts, such as both attachment and perfection, that have well-established significance in secured transactions.

The second reason for adoption of the concept of attachment is that the Department wanted to establish that if automatic perfection of a security interest lapsed, the security interest itself would not lapse but would merely become unenforceable against third parties. Although it may be the rare case in which such a question should arise, making no provision for it seemed to leave an unnecessary gap.

Because of the criticism of its incorporation in the March Rule, the Department has eliminated use of the term "attachment" but has not eliminated the three basic requirements associated with attachment of a security interest. In doing so, it was noted that one of the commenters recommending elimination of the concept also would have retained two of the requirements of attachment -- that the debtor have rights in the collateral and that the secured party give value.

Two comments agreed, in principle, with the requirement of a written security agreement as an element of perfection of a

security interest. Two other comments objected to this requirement, however, stating that a written agreement is unnecessary except in certain cases, i.e., in the case of temporary perfection and in the case of any clearing lien.

The Department agrees that a written agreement should be a requirement for automatic perfection and a requirement for according priority to a clearing lien. The clearing lien requirements are discussed in the analysis of Section 357.15. In the case of automatic perfection, it is appropriate to require a written agreement because perfection does not depend on book-marking or some other act of a book-entry custodian. In other types of perfection, the interests in a security can be discerned from the records of the book-entry custodian and confirmed upon request. As a result, the requirement of a written agreement has been eliminated from these rules in the case of these other methods of perfection. In those cases, transfer of the security or security interest will be sufficient to perfect the security interest, assuming the basic requirements set forth in Section 357.13(a) have been complied with.

The March Rule provided for "automatic" or "temporary" perfection of a security interest for a period of 7 calendar days. Thereafter, the security interest would continue to be perfected only if there were a transfer of the security or the security interest and the security agreement were reduced to writing.

Several comments urged that a security interest perfected by the automatic method should be subordinated to all other interests in the same security. These comments were concerned about innocent third parties or purchasers taking a security subject to such an interest, without having any means to determine whether the interest exists. As pointed out in one comment, however, this risk would be mitigated by a bona fide purchaser concept.

The revised rule retains the concept of automatic perfection. The rules also contain a modified bona fide purchaser provision in Section 357.14 under which an innocent third party could prevail over parties having perfected security interests, especially those perfected only by means of automatic perfection and not reflected on the books of a book-entry custodian.

Although one comment endorsed lengthening the automatic perfection period to the 21 days provided in existing law, other comments lent support to the view that the 7-day period was adequate. This rule retains the 7-day period.

Several commenters expressed concern about Section 357.14(d) of the March Rule which described the methods of terminating a security interest. Section 357.14(d) had provided, among other things, that a security interest could be terminated by a transfer of the interest to a designee or successor in interest

of the grantor of the security interest. The concern expressed was that this could be interpreted to mean that a dealer that had granted a security interest to its clearing bank could unilaterally terminate the security interest by transferring securities subject to the security interest to a customer.

The Department did not intend this section to permit unilateral termination of a security interest by the debtor. The term "successor in interest" was added simply to provide for the situation where the debtor had been merged into or acquired by another entity. The term "designee" was included simply to provide flexibility and not require transfer solely to the debtor as the means for terminating a security interest. For example, under this provision, a clearing lien would terminate if a clearing bank on the instruction of its dealer-customer, transfers a security from the dealer's clearing account to another account at the clearing bank or to another book-entry custodian maintaining a securities account at a Federal Reserve Bank.

Because of the comments described above, the Department has added the phrase "by or with the agreement of the secured party" to Section 357.13(e) to clarify that termination of a security interest requires the agreement of both the debtor and the secured party. However, it should be noted that this provision is not intended to suggest that a valid rehypothecation of securities, such as a dealer might do with customer securities

purchased on margin, would terminate the initial security interest on which the rehypothecation was based.

One commenter also would have added a definition of "value" to Section 357.3 to make it clear that value includes antecedent debt. The Department believes that this is the result that would be reached by looking to State law as described above in Section 357.2.

The same commenter also suggested that it be clarified that the concept of "value" does not require a one-for-one identification with the security that is the subject of the security interest. Presumably, the comment is made with a view toward the clearing lien granted by a dealer to its clearing bank where credit may be extended by a clearing bank during the day but it is not possible to pinpoint the specific security purchased by the dealer that requires the extension of credit. The Department does not believe that the regulations imply any requirement that the credit extension be tied to a specific security. It appears that uncertainty on this point would more appropriately be handled in the clearing agreement itself. It is the Department's understanding that a clearing agreement generally is drafted to provide that the clearing bank has a security interest in all unsegregated securities in the dealer's clearing account. Because of this structure, the clearing lien is in effect a floating lien that attaches to securities while they are in that account.

Section 357.14 This is one of two sections dealing with the issue of resolution of competing claims that was discussed in detail in the March Rule. See 51 FR 8848-50. Although several alternative approaches were considered prior to the March publication, the Department ultimately decided to leave resolution of competing claims to State law. However, the Department also specifically invited comments on the issues discussed and suggestions of specific provisions dealing with competing claims.

One of the specific alternatives considered by the Department was the incorporation in this rule of a traditional bona fide purchaser ("BFP") rule. In the March Rule, the Department expressed three concerns with adoption of such a rule. The first was a theoretical concern about structuring such a rule for the book-entry environment. The second was a more practical concern that the concept of a BFP may be of limited use in a tiered book-entry system where transactions affecting a transferee's rights in a security can occur at any time after the transferee acquires BFP status. The third concern expressed by the Department was that a BFP provision could affect the efficiency and liquidity of the government securities market if it impaired the ability of clearing banks that extend daily credit to government securities dealers to collateralize their dealer loans.

The Department received eight comments that were addressed

to this issue. Three commenters provided specific proposals for dealing with competing claims to securities that would include incorporation of a bona fide purchaser rule and a provision expressly providing priority for clearing liens. In addition, three commenters suggested other alternatives for resolving the issue of competing claims, and four other commenters favored a Federal rule on priorities of competing claims, although they did not suggest specific regulatory language.

After careful consideration, the Department has adopted an approach to competing claims similar to the approach suggested by the three commenters first referred to above. The Department has added a modified BFP rule in Section 357.14 and a new priority provision for clearing liens in Section 357.15.

The three commenters suggesting this approach include a major clearing bank, an association of government securities dealers, and an ad hoc group of attorneys from the Section on Corporations, Banking and Business law of the American Bar Association. These three commenters, as well as a number of other commenters on the issue of competing claims, all emphasized the importance of the role played by clearing banks in the government securities market. For example, one commenter stated:

> As currently structured, the government securities market could not operate efficiently without daily extensions of credit by clearing banks because clearing banks routinely permit transfers of securities from their accounts with a Federal Reserve Bank even though the funds to pay for such transfers

may not be available to the clearing bank until several hours after the transfer of such securities.

As the Department recognized in the discussion of the competing claims issue in the March Rule, such extensions of credit must be fully collateralized to satisfy the safety and soundness requirements of the bank regulators.

Adoption of an unlimited BFP rule would create a significant risk to clearing banks since their security interest in securities in a dealer's clearing account could be cut off if the dealer, on its own books, transfers those securities to customers who would qualify as BFPs. To balance the interests of lower-tier investors against the need for the clearing banks to fully collateralize their extensions of credit to dealers, the Department decided to adopt the approach suggested by the three commenters referred to above that would incorporate a BFP rule but expressly provide that a qualifying clearing lien will have priority over all other claims to the same securities including those of a BFP. The Department views this approach, which provides priority only for qualifying clearing liens, as preferable to an approach that would provide a more general rule favoring the claim of all upper tier book-entry custodians over the lower tiers.

Section 357.14 expressly provides that a transferee may qualify as a good faith transferee if it acquired its interest

for value, in good faith and without notice of adverse claims. To qualify as a transferee for purposes of this section, one must acquire a security under Section 357.12(a)(1), (3), or (5). This is to parallel somewhat the common law requirement that to qualify as a BFP one must take delivery of the property. As with the traditional BFP concept, a good faith transferee takes a security free of all adverse claims. In effect, the rule eliminates the possibility of tracing securities beyond what one's book-entry custodian itself maintains. The Department considers this to be an appropriate result given that book-entry securities of the same issue are fungible and generally not subject to tracing.

One commenter suggested that the BFP rule also should provide that for transfers of securities from TRADES to an account in TREASURY DIRECT or for transfers on the books of a clearing corporation, the transferee could qualify as a BFP. The Department believes that for transfers from TRADES to TREASURY DIRECT, such a provision is unneeded. Section 357.21 of the TREASURY DIRECT rules provides that the form of registration of a security in TREASURY DIRECT is conclusive evidence of ownership. Such a rule is intended to preclude any assertion of adverse claims to a security held in TREASURY DIRECT. The Department has decided not to include transfers on the books of a clearing corporation at this time for the same reasons described below that the Department has not included a clearing lien priority for clearing corporations.

The same commenter also suggested a provision that would permit explicitly the transfers of limited interests in securities to TREASURY DIRECT accounts. The commenter stated that, but for language in Section 357.25 of the TREASURY DIRECT rules stating that the Department will not recognize any claims of security interests, many secured parties, including public bond trustees, would use TREASURY DIRECT for secured transactions. The Department is considering the possibility of allowing TREASURY DIRECT to be used for trust indentures but believes any revision would require a change to the TREASURY DIRECT provision rather than the provisions set forth below.

In drafting its modified BFP rule, as suggested by one commenter, the Department chose the phrase "good faith transferee" rather than "bona fide purchaser" to highlight the fact that, as described below, under these proposed rules the rights of a purchaser who acquired a security in good faith, for value and without notice of adverse claims are somewhat less broad than the rights of the traditional bona fide purchaser. Although as a matter of semantics the phrases are virtually synonymous, the Department believes it is appropriate to use a phrase that is somewhat less recognized as a legal term of art than is the phrase "bona fide purchaser."

Under Section 357.14, the interest in a security of a transferee who qualifies as a good faith transferee would be subject to two categories of potential adverse claims. First,

Section 357.15 provides generally that a qualifying clearing lien will have priority over all other interests in a security including that of a good faith transferee. In effect, the rule provides that any transferee acquiring a security through a dealer or other entity that acquires securities through a clearing arrangement is deemed to have constructive notice of any clearing lien attaching to the transferee's security. The details of the clearing lien priority are set forth in the discussion of Section 357.15 below.

In addition to the provision for a priority of a clearing lien, a good faith transferee's interest may be limited by the claims of other good faith transferees claiming the same security through the same book-entry custodian. Three of the commenters offering specific proposals to deal with competing claims recommended adoption of a similar rule. As one commenter noted, "in those cases in which the adverse claimants are customers of the same book-entry custodian," the application of a strict "last in time" priority rule produces an arbitrary result. All customers of the same book-entry custodian will generally have precisely the same relationship with the book-entry custodian and all should share pro rata the risk that the book-entry custodian will not have enough securities of the appropriate issue to satisfy all of the claimants. The rule would provide that such customers are good faith transferees but only to the extent of

their pro rata share of the appropriate securities. This provision is not intended to preempt other federal law, such as the Bankruptcy Code or the Securities Investor Protection Act, on the distribution of assets in an insolvency.

A fourth comment letter that addressed the issue of competing claims also would have specified that transferees may qualify as bona fide purchasers under certain circumstances. However, instead of a specific provision dealing with clearing liens this commenter would have provided more generally that the rights of any lower-tier transferee would always be subject to the rights of higher-tier transferees. To mitigate generally favoring the upper-tiers over the lower tiers, this commenter also suggested a provision whereby a lower-tier transferee could protect its interests by requesting segregation of its securities. However, the Department is reluctant to adopt the remainder of this proposal which essentially would rely on segregation of securities. Our primary concern is that segregation is not currently a regulatory requirement that is enforced by periodic inspection of books and records. Furthermore, recent litigation suggests that even where segregation is used, it is not always maintained so as to protect properly all fully-paid securities held for customers. Legislation has been enacted that would provide for regulation of brokers and dealers in government securities and that would grant both the rulemaking and enforcement authority necessary to establish a reliable system of segregation of customer

securities. However, until such a system is in place, the Department is reluctant to promulgate a rule that relies so heavily on segregation as a means of protecting an investor's interests.

An added concern is that to provide effective protection of the lowest tier under this proposal, segregation must occur at every level in the chain of accounts. Given that each tier generally only has knowledge of those with whom it deals directly, such a requirement would leave too much to chance and generally would make protected status of a customer at a lower tier depend upon too many events beyond that customer's control and upon facts it could not verify.

Two other commenters, in a joint letter, favored retaining Subpart O with one modification to correct what the commenters identified as the sole interpretative issue that has arisen under the existing regulations. The issue arose in Wichita Federal Savings & Loan Association v. Comark, 610 F. Supp. 406 (S.D.N.Y.), vacated, 610 F. Supp. 418 (1985). The commenters' concern with the court's decision in that case is that it would have allowed a secured party, such as a clearing bank, to be ousted of its security interest by the unilateral act of its dealer-customer. Although the court's decision was vacated, the commenters suggest that, in order to prevent any similar decision in subsequent litigation, the existing regulations be amended to state explicitly that entities holding securities directly on the

books of a Federal Reserve Bank shall be deemed to be in the sole and exclusive possession of the securities. Although the proposal certainly would resolve the one interpretative issue raised by Comark and eliminate any uncertainty for entities holding securities on the books of a Federal Reserve Bank, we believe it does not adequately take into account other interpretative questions that have been raised under Subpart O. Furthermore, the proposal does not take into account the multiple interrelationships that exist in the government securities market.

In addition to the comments discussed above, one other commenter appeared to favor adoption of the State law concept of a bona fide purchaser, but felt that the proposed rule would provide only interim benefit in light of the then-pending legislation that would establish regulation of brokers and dealers in government securities. (Such legislation was enacted by Congress on October 6, 1986.) The Department believes this comment is based on a misperception about the types of regulations that Treasury may promulgate pursuant to the legislation. Although such regulations may include requirements concerning safekeeping of customer securities, it is unlikely that such regulations would become the sole basis for establishing substantive rights in securities or that they would be the basis for resolving all competing claims to securities.

Section 357.15 Under this new section, a qualifying clearing

lien is one which arises under a written agreement between a book-entry custodian and an entity providing clearing services. Clearing services are defined as delivering and receiving securities and payments for securities on behalf of other persons. A qualifying clearing lien may be asserted only by a depository institution maintaining a book-entry securities account at a Federal Reserve Bank through which the entity provides clearing services.

The Department considered providing clearing lien priority for entities not having direct access to a Federal Reserve Bank. However, given that a qualifying clearing lien may defeat the interests of a dealer's customers, it seemed advisable to limit the category of entities that could assert clearing lien priority. Furthermore, the Department believes that the level of clearing services engaged in by institutions not having accounts directly with a Federal Reserve Bank is so small that it would not justify opening up the availability of the clearing lien priority to a whole new range of institutions.

The Department intends for the provision as drafted to permit clearing lien priority for all entities currently performing clearing services for a significant number of government securities dealers. The Department recognizes that, in some cases, a portion of the clearing services performed by a depository institution through a securities account at a Federal Reserve Bank may be carried out by an operating subsidiary or an

affiliate under common control with such depository institution. However, the Department has assumed that the actual extension of credit which requires the clearing lien is extended by the depository institution rather than the subsidiary or the affiliate.

The clearing lien priority is further limited by requiring that the clearing bank acquire it in good faith. This requirement is intended to exclude the availability of the priority only in cases where an institution has engaged in egregious practices. It is not intended to suggest that a clearing bank is under an obligation, as a general proposition, to investigate whether or not a dealer's customers may have a claim to the same securities that are subject to the clearing lien. For example, the majority of book-entry securities transfers are completed without human intervention through computer links between Federal Reserve Banks and depository institutions. The electronic transmissions usually contain information about parties involved in the underlying transaction. That information is ordinarily reviewed only by the book-entry custodian which is doing business with the ultimate transferee. The mere presence of that type of information should not affect the good faith of other book-entry custodians involved in a transfer. A clearing bank must be able to rely on its dealer-customer in identifying securities that are available to use as collateral for credit extended by the clearing bank.

There are three other limitations to the clearing lien priority in addition to the requirement of good faith. First, the priority is available only to the extent of credit actually extended in providing clearing services. This limitation serves to preclude assertion of the priority for other extensions of credit by a bank to its dealer customer. For those credit extensions, the Department believes that the entity extending credit outside a clearing arrangement whereby the entity finances the purchase of the securities used as collateral should bear any risk that the customer is using as collateral securities to which others might have legitimate claims.

As another limitation, the proposed rule specifically provides that a clearing lien may not be asserted against securities segregated as fully paid customer securities on the clearing bank's books. Although, as was discussed above, the Department chose not to link protection of lower tiers to segregation of securities, since segregation is not a currently required practice, the Department nevertheless believes that where segregation is maintained, it should be given its intended effect.

Two of the commenters favoring a clearing lien priority and adoption of a BFP rule would have given similar effect to segregation on the books of a clearing bank. However, these proposals would have gone further and precluded assertion of a clearing lien once the clearing bank received a notice to

segregate from its dealer customer. Such a rule would appear to create a problem similar to that discussed above in connection with the Comark case: a clearing lien could be effectively terminated by the unilateral action of someone other than the entity that is a secured party. Although in many cases the rule may not present a problem because there will be more than enough collateral in the account subject to the clearing lien, it would appear to create an unacceptable level of uncertainty given the amount of credit extended by clearing banks on a regular basis.

As a final limitation, the clearing lien priority is effective only against claims of third parties. It may not be asserted to defeat an interest granted by the clearing bank itself.

Two commenters proposed that provisions be added to the proposed rule to permit a clearing corporation to qualify for the proposed clearing lien priority. A clearing corporation would be defined using the definition of clearing corporation set forth in Article 8 of the UCC, with certain changes intended to permit inclusion of existing registered clearing agencies.

The Department believes that there currently are no entities involved in the Treasury securities market that would fall within the definition of a clearing corporation. However, it has been brought to the Department's attention that more than one proposal is being considered by entities in the private sector, including

one of the commenters referred to above, that would establish a clearing corporation for Treasury securities. The proposals are aimed at establishing a system for netting daily transactions among major participants to cut down on the number of actual transfers of securities that take place and to diminish the amount of funds that will actually move over fedwire. The Department believes that such an arrangement, properly structured, could enhance the efficiency of the market and has no wish to discourage full exploration of the possible approaches to netting and resolution of the various legal issues that would arise in structuring a netting arrangement. However, given the preferred position of a clearing lien under the proposed rule, the Department is reluctant to include provisions at this time that would allow assertion of the clearing lien by an entity of yet undetermined character. The Department believes that as the proposals become more concrete it will be easier to evaluate the appropriate way in which the arrangement may be taken into account in the regulations. A clearing lien priority may well be appropriate and the Department believes that such amendments to the rule as may be necessary would not require significant restructuring of the rules and would be relatively easy to accomplish. For these reasons, the Department decided not to include provisions dealing with clearing corporations at this time.

Section 357.16 [Section 357.15]. This section describes the duties of a book-entry custodian to provide confirmations and

acknowledgments. The March Rule combined the duties and warranties of a book-entry custodian in a single section numbered 357.15. In these rules, the warranty provisions are in a new Section 357.17 discussed below.

The March Rule stated that a book-entry custodian must send confirmation of a transfer of a security to the transferee no later than the close of business on its next business day after the day on which the transfer entry is made. The rule also provided that a book-entry custodian must send an acknowledgment of (i) the entry of a security interest on its books, or (ii) the receipt of notice of a security interest, by the close of business on its next business day after the day on which the entry is made or the notice is received, respectively.

Several comments were received relating to the use of the terms "confirmation" and "acknowledgment." It was suggested that the term "transaction statement" or "acknowledgment" be used in place of "confirmation" because of the potential confusion over the existing usage of the term "confirmation" and a possible implication that compliance with rules on confirmations promulgated by the Securities and Exchange Commission or other regulatory authorities might be required. On the other hand, another comment urged the elimination of the term "acknowledgment" in favor of the term "confirmation" because of the latter term's accepted meaning in the securities industry.

This rule retains the term "confirmation" in connection with security transfers and the term "acknowledgment" in connection with transfers of limited interests. The term "confirmation" is used in a general sense and is intended to refer to the existing practice of the issuance of a memorandum setting out the relevant details of a trade. It is not intended to imply that compliance with other regulatory requirements would automatically be required. The term "acknowledgment" is also used in a general sense. A term other than "confirmation" was chosen in connection with transfers of limited interests (including security interests), because it did not appear that the procedure set forth in the rule would necessarily correspond to existing terminology.

With respect to acknowledgments of limited interests marked on the books of a book-entry custodian, the March Rule stated that an acknowledgment must be sent to both the transferor and transferee of the security interest, on the assumption that both parties would have an established customer relationship with the book-entry custodian. Two comments pointed out that, in such a situation, it is likely that the book-entry custodian will not have a customer relationship with the secured party, and that the book-entry custodian may know nothing about the secured party other than the secured party's name. For this reason, a provision was added to this rule to the effect that if the book-entry custodian does not have the address of the transferee of the limited interest, then the transferee's acknowledgment

shall be sent to the transferee at the address of the transferor.

It should be noted that because the notice-type transfer of a security interest (Sec. 357.13(c) of the March Rule) has been eliminated, the corresponding requirements for acknowledgment of that type of transfer have also been eliminated. It should further be noted that since acknowledgments are only required for transfer of a limited interest by the book-marking method under Section 357.12(a)(4), a clearing bank would not be required to provide confirmation of its clearing lien to a dealer because a transfer of a security interest in those circumstances occurs under Section 357.12(a)(5).

The March Rule also included a provision (Sec. 357.15(d)) that stated that a book-entry custodian must provide to a customer, or to another person designated by the customer, upon written request, information as to the 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. This provision has been retained, but in response to a number of comments, several clarifications have been made.

Several comments raised a question about the meaning of the term "security" in this context and expressed concern about a violation of confidentiality if disclosure of the interests of other customers in securities of the same issue would be

required. The language in paragraph (c) of this section has been clarified to indicate that only customer interests "in that same security" need be disclosed. For example, assume that a book-entry custodian ("book-entry custodian #1") maintains $500,000 of Treasury notes of a particular issue in its account at another book-entry custodian ("book-entry custodian #2"). A customer of book-entry custodian #1, who owns a $5,000 Treasury note of that same issue, as reflected on book-entry custodian #1's books, requests a statement under Sec. 357.16(c) of these rules. The statement book-entry custodian #1 would be required to provide would relate only to the $5,000 Treasury note owned by the customer. However, book-entry custodian #1 would be required to identify any interests that affect either that particular note or the entire aggregate amount of notes maintained on the books of book-entry custodian #2 for the account of book-entry custodian #1.

A statement issued by a book-entry custodian under Section 357.16(c) must reflect the interests recorded on the book-entry custodian's books, and interests granted by, or in favor of, the book-entry custodian, as of the date the customer's request is received. A book-entry custodian has no obligation to advise the requester of changes that occur thereafter, unless the customer subsequently requests another statement. This rule also recognizes that to constitute an adequate request from a customer, the request must be in writing, must provide the address to which a response is to be furnished, and must be

received in the department of the book-entry custodian responsible for maintaining records of book-entry securities.

A suggestion was made that the regulations should cover the question whether a standing request by a customer must be honored, and if so, when the request would become stale. This suggestion was not adopted because the Department is of the opinion that this is a matter that can be resolved by agreement between a book-entry custodian and its customer.

A number of banking institutions objected in principle to the confirmation requirements, pointing out that under rules of the Federal Reserve and other regulatory agencies, they are already subject to confirmation and record-keeping requirements in effecting securities transactions for customers. The Department agrees that if these financial institutions are already subject to such requirements, there would be little purpose in subjecting them to another set of requirements. Therefore, this section of the regulations has been amended to provide that if a book-entry custodian is subject to Federal banking regulation requiring that a confirmation be furnished to a customer for whom it effects a securities transaction, then the book-entry custodian is not subject to the confirmation requirements of these regulations, provided the book-entry custodian is in compliance with the banking regulation.

Several comments also expressed the view that a book-entry

custodian and customer should be permitted to agree to waive the confirmation requirements, such as in a case where a customer only wishes to receive a statement periodically, in lieu of a confirmation of each transaction. Under these rules, a waiver is permissible only if it is specifically authorized by other Federal regulations. The Department is reluctant to sanction a waiver in other cases, because it appears such a practice could be used to undermine the protections intended to be provided by this section.

Section 357.17 [Section 357.15]. The March Rule provided that by sending a confirmation of a transfer of a security, a book-entry custodian would (i) warrant to its transferee, and any subsequent transferee, that it had made an appropriate entry on its books, or that such an entry would be made before the book-entry custodian next opens for business, and (ii) warrant the book-entry custodian's good faith and authority. The warranty of good faith and authority included a warranty that the security described was free of claims of, or claims created by, the book-entry custodian, except as specifically noted on the confirmation; and a warranty that, to the knowledge of the book-entry custodian, the security described was free of claims, except as specifically noted on the confirmation. The March Rule also provided that by issuing a confirmation upon the request of a customer, a book-entry custodian would warrant to its customer that the information provided therein was accurate.

This section changes, to some extent, the warranties given by a book-entry custodian, and also includes warranties for other transferors of a security or security interest.

Most of the comments that addressed warranties agreed that it is appropriate for a book-entry custodian to give certain warranties, although one financial institution objected to the warranties on the basis that they would not encourage any greater degree of care on the part of the book-entry custodian. The Department agrees with the majority of the comments. Although warranties admittedly provide only limited protection to investors, such protection may have a beneficial effect. Also, as pointed out by the comments, under existing law, an "intermediary" warrants its good faith and authority. (See Section 8-306(3) of the UCC.)

One financial institution suggested that a book-entry custodian should not be liable for consequential or special damages for breach of warranty, in view of the potential for large losses. This section does not address the measure of damages for breach of warranty. The Department is of the view that damages for breach of warranty could be limited by agreement between the parties to the securities transaction, provided the limitation is not unconscionable. Also, it is noted that as a general rule, consequential damages are not recoverable unless they are foreseeable.

The March Rule provided that the book-entry custodian's warranty to a transferee would arise upon the sending of a confirmation. A comment was made to the effect that the warranty should attach at the time the books are marked (i.e., the time of transfer) rather than when the confirmation is sent. The Department agrees that it is desirable for the warranty to attach at the time an entry is made, because this will normally occur at an earlier point in time than the time when the confirmation is sent. Consequently, paragraph (a) of this section states that a book-entry custodian's transfer warranty arises in connection with the actual transfer of a security or an interest in a security in accordance with Section 357.12.

The March Rule also provided that the warranty of a book-entry custodian would run to its transferee and any subsequent transferee. Two comments urged that the warranty run only to the immediate transferee, for reasons of consistency with existing law and the inability, in any event, of a subsequent transferee to trace a book-entry security. The Department agrees that each transferor should only give a warranty to the party with whom it deals, and this section has been changed accordingly.

Several comments expressed concerns about the warranty that a security is free of claims of, or claims created by, the book-entry custodian, and other claims of which the book-entry custodian has knowledge, except as specifically noted on the

confirmation. With respect to "claims of" the book-entry custodian, two financial institutions pointed out that it may be difficult to describe a book-entry custodian's claims against its customer specifically, since many different circumstances could result in a lien or charge under the applicable custody or other agreement, and that such circumstances may not be known at the time a confirmation is sent. Because the claims between a book-entry custodian and its customer should already be known to the customer, there is no purpose in requiring that these claims be noted on a confirmation. Thus, the language relating to "claims of" a book-entry custodian has been deleted.

In connection with the claims of third parties of which the book-entry custodian has knowledge, several banks commented on their potential exposure if notices of claims are received at an office other than where the customer's account is maintained. Although these comments were prompted primarily by the provision on notice-type transfers of security interests (Section 357.13(c) of the March Rule), which has been eliminated in this proposed rule, the Department has considered whether it would be appropriate to define what constitutes "knowledge" of claims by a book-entry custodian. The Department has concluded that because of the many types of organizations involved and the unpredictability of the potential factual situations, it would be difficult to prescribe such a rule. It should be noted, however, that the Department would not consider a general disclaimer by the book-entry custodian noted on the confirmation acceptable

compliance with the warranties required under paragraph (a).

A suggestion was made that a warranty should be made that, at the time of the transfer, a sufficient quantity of securities of that issue is in the transferor's account to effect the transfer to the transferee and all contemporaneous transfers to other transferees. The Department is of the view that such a provision would focus on the timing of transfers with a precision that does not actually correspond to the realities of trading in an electronic book-entry system. Nonetheless, the Department believes it is appropriate for a book-entry custodian to warrant that the security being transferred is actually present in the book-entry custodian's own account. Thus, the book-entry custodian's warranty of good faith and authority has been expanded in paragraph (a) of this section to include a warranty that the security is part or all of an amount of the same security maintained in an account of the book-entry custodian on the books of another book-entry custodian or on the books of a Federal Reserve Bank.

Another comment was made to the effect that a book-entry custodian's warranty of good faith and authority should include a warranty that a security will not be transferred from a customer's account except upon instructions from the customer or a court of competent jurisdiction. The rationale for this proposal was to provide a basis for a Federal claim against a book-entry custodian who acts negligently or fraudulently in

transferring securities from an account of a customer. The Department has decided not to include it in these rules for the reason that it does not appear it would realistically create any added protection for investors.

Paragraph (c) of this section adds a warranty that is applicable to any transferor of a security or an interest in a security, other than the United States or a Federal Reserve Bank. Such a transferor warrants to its transferee that the transfer is rightful and effective and that the transferor is acting in good faith. Paragraph (b) of this section provides that where a book-entry custodian is also the transferor of the security or an interest in a security, it will warrant to the transferee that the transfer is rightful and effective, in addition to the other warranties given by a book-entry custodian.

The transferor warranty was added in response to comments stating that a seller which is not a book-entry custodian should also give certain warranties to the purchaser. Under the regulations currently in effect, which are based on the concept that a book-entry security is deemed to be the equivalent of a bearer definitive security, a transferor would give such warranties under applicable law, among them a warranty that the transfer is effective and rightful (Section 8-306 of the UCC). With the elimination of the bearer definitive fiction, commenters pointed out that the transferor warranty also would have been inadvertently eliminated in those states that have not adopted

the revised UCC Article 8 (applicable to uncertificated securities).

The March Rule contained a provision stating that by sending a confirmation upon specific request of a customer, a book-entry custodian would warrant that the information provided therein is accurate. One comment was made to the effect that this provision should be deleted in the case of banks, which are already held to a high standard of care. The provision has been retained as paragraph (d) of this section because it does not appear to create any new administrative burden for book-entry custodians.

Paragraph (e) of this section retains the provision in Section 357.15(f)(1) of the March Rule that by sending a confirmation of a transfer, a book-entry custodian warrants that it has made a transfer entry or that such an entry will be made before the book-entry custodian next opens for business. Although a book-entry custodian's warranty will arise under paragraph (a) of this section upon the transfer of the security or an interest in the security, rather than upon the sending of a confirmation, it is necessary to provide some assurance that an entry actually has been made or will be made before the book-entry custodian next opens for business. Thus, paragraph (e) provides that by sending a confirmation of transfer in accordance with Section 357.16(a) or pursuant to a similar requirement under other Federal regulation, a book-entry custodian warrants that it has made a transfer entry as described

in Section 357.12(a)(3) or that such an entry will be made before the book-entry custodian next opens for business.

Paragraph (f) of this section provides that the warranties described in this section may not be disclaimed or limited by agreement. It is noted that the obligations of good faith, diligence, reasonableness and care prescribed by the Uniform Commercial Code may not be disclaimed by agreement, although the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable (See Section 1-102(3) of the UCC). Paragraph (f) of this section makes clear that the warranties in these rules preempt other provisions of law which might permit the disclaimer or variation of warranties by agreement. The warranties in these rules are intended to set standards for good faith, reasonableness, and care in the applicable transactions.

Section 357.18. This section, which describes when a duty to transfer is fulfilled, is new. It was added in response to comments on the March Rule to the effect that by prescribing a Federal rule on securities transfers, the existing State law on the obligation of a transferor to deliver a security had been altered or eliminated (see UCC § 8-314).

Paragraph (a) of this section states that a book-entry custodian fulfills its duty to transfer a security at the time it

makes an entry on its books or instructs another book-entry custodian or Federal Reserve Bank to make an entry or it instructs its book-entry custodian or Federal Reserve Bank to transfer the security to TREASURY DIRECT. The intent is that the action that must be taken is the action that is appropriate for the circumstances. For example, if a customer of a book-entry custodian (BEC #1) which maintains an account at another book-entry custodian (BEC #2) instructs BEC #1 to transfer a security to a purchaser who maintains an account at a third book-entry custodian (BEC #3), then BEC #1 has fulfilled its duty to transfer at the time it instructs BEC #2 to make a transfer entry.

Paragraph (b) provides that a transferor other than a book-entry custodian, a Federal Reserve Bank, or the United States, fulfills its duty to transfer at the time it instructs its book-entry custodian to make an entry on its books or to instruct another book-entry custodian or Federal Reserve Bank to make an entry or to transfer the security to TREASURY DIRECT. As described above, the applicable action should be appropriate to the circumstances. In addition, the transferor must instruct its book-entry custodian in the manner required by the book-entry custodian.

Section 357.19 [357.16]. Section 357.16 of the March Rule dealt with the priority of interests of the United States. It provided that a security interest in a security transferred to the United

States to secure deposits of public money, deposits to Treasury tax and loan accounts, or pursuant to a similar requirement of Federal statute or regulation, shall be superior to any other interest in the security. It also provided that a security transferred to the United States shall be free of adverse claims, unless the security was acquired in a transaction in which the United States was acting in a proprietary, rather than governmental, capacity. Those provisions have been retained and redesignated as Section 357.19 of this rule.

Comments were made to the effect that some limitation should be included on the ability of the United States or a Federal Reserve Bank to claim securities under these provisions that have been segregated for customers. Other comments raised the possibility that a security interest granted to the United States could operate as a "secret lien" and could cut off the claims of other parties without notice. For example, if an individual were to grant a security interest to the United States, interests of others such as a clearing bank or a dealer would be subordinated to the interest of the United States.

As noted in the discussion of the March Rule, a priority for security interests in favor of the United States is appropriate in the circumstances described because the security interests run to the benefit of the general public. As a practical matter, it is unlikely that there would be competing customer interests in any securities in which a security interest has been granted to

secure Treasury tax and loan and similar accounts, because such securities are transferred on the books of a Federal Reserve Bank to a specific account maintained for the United States.

This section relates only to interests of the United States and the Department. It does not address the interests of a Federal Reserve Bank arising from its extension of credit to a clearing bank. See Section 357.15 with respect to the clearing lien of a Federal Reserve Bank.

Another comment made the suggestion that in lieu of the distinction between a "proprietary" and "governmental" capacity used in this provision, that a "commercial"/"governmental" distinction would be preferable, based on concepts in statutes such as the Foreign Sovereign Immunities Act. The comment was also made that the qualification that priority treatment would only apply to transfer of a security to the United States when the United States is acting in a "governmental" capacity should apply as well to transfers of security interests to the United States.

The Department has decided to retain the term "proprietary" because the suggested concept of a "commercial" capacity does not appear to be illuminating in this context. Arguably, the nature of every securities transaction is "commercial." With respect to the application of the governmental/proprietary concept to transfers of security interests, the Department is of the view

that transfers of security interests to the United States as required by Federal statute or regulation are inherently governmental in nature, and it is thus unnecessary to introduce the concept in this part of this provision.

A new sentence was added to the end of Section 357.19 to clarify that a security or a limited interest in a security required by statute or regulation that is transferred to the name of any executive department of the United States has the same priority as a security or limited interest transferred expressly to the United States or the Department. The term "executive department" is defined in 5 U.S.C. § 105.

Section 357.20. This section, which is new, describes the general authority of the Federal Reserve Banks, as fiscal agents of the United States, to issue, service, maintain, and transfer book-entry securities, and to make related payments of principal and interest. The provision simply restates a similar rule in Section 306.116 of Subpart O.

Section 357.21 [357.17]. Section 357.17(b) of the March Rule provided that the United States and the Federal Reserve Banks would be entitled to treat the entity in whose account a security is credited as the entity exclusively entitled to transfer the security and would not be liable for acting on the instruction of that entity. This provision now appears in paragraph (b) of this section of these rules.

One comment was made that this provision could be interpreted to permit the United States or a Federal Reserve Bank to exercise a right of set-off against securities in an account where the interests of third parties could be jeopardized. This section is not intended to address the property claims of the United States or a Federal Reserve Bank and is intended solely to enable the Federal Reserve Banks to continue to operate the Fedwire securities transfer mechanism through automated transmissions that are not reviewed by Federal Reserve Bank personnel. The property claims of a Federal Reserve Bank that may arise from extensions of credit to banks must be established or perfected as provided for in other parts of these regulations. Policy matters associated with such claims are being addressed separately by the Board of Governors of the Federal Reserve System.

Section 357.42. Paragraph (b) of Section 357.42 of the proposed rule provided, in part, that in the event that the United States is unable to make a payment when due, the liability of the United States would be limited to the amount of the payment. This provision has been retained.

One comment was made suggesting that the provision be amended to state that for principal payments that are not made when due, interest at the contract rate would continue to accrue. This suggestion has not been adopted because the Department has no authority to pay interest after the maturity of a security and

no funds have been appropriated for that purpose.

Section 357.44. This section, which is unchanged from the March Rule, states that notices of judicial proceedings affecting a security are to be directed to the Federal Reserve Bank or book-entry custodian, as appropriate, whose books show the interest of the person against whom the proceedings are directed.

A suggestion was made that the provision be changed to provide that an enforcement order is not effective until the Federal Reserve Bank or book-entry custodian receives written process or notification at the appropriate location. The Department has decided not to expand the provision as suggested because it is intended to be merely informational in approach. It is not intended to reach substantive questions of the effectiveness of notices or orders.

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: NOV 20 1986

Gerald Murphy

Gerald Murphy

Fiscal Assistant Secretary

Part 357 of subchapter B of Title 31, Code of Federal Regulations, Chapter II, is proposed to be amended by adding Sections 357.0, 357.1 and 357.2, by revising Section 357.3, by adding Subpart B, Section 357.42, and 357.44, 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)

357.40 Additional requirements.

357.41 Waiver of regulations.

357.42 Liability of Department and Federal Reserve Banks.

357.43 Liability for transfers to and from TREASURY DIRECT.

357.44 Notices of attachment for securities in TRADES.

357.45 Supplements, amendments or revisions.

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

Subpart A -- General Information

Sec. 357.0 Dual book-entry systems.

Securities to which this Part applies, as set forth in Section 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 is credited to a TREASURY DIRECT account as described in Section 357.20 of this Part.1/ See Subpart C for rules pertaining to TREASURY DIRECT.

1/ TREASURY DIRECT accounts are 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 the Public Debt.

Sec. 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 Subparts A, B, and D 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 rights and duties of the United States with respect to any security issued and outstanding prior to the date such security becomes eligible to be maintained in TREASURY DIRECT. In addition, these rules shall not affect the rights that 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 Subparts A, B, and D of this Part in final form] and that was rightful and effective under the regulations

and law then applicable to such outstanding security.

(b) For purposes of determining the applicability of Subpart B of this Part to a transaction in a security in accordance with paragraph (a) of this section, a transaction involving a transfer of a security or a limited interest in a security will be deemed to have occurred on the date on which occurs the act that constitutes the transfer of the security or of the limited interest in a security as described in this Part. For purposes of the preceding sentence, the parties to a transaction that will involve two or more transfers of a security or a limited interest in a security and that will continue beyond the date specified in paragraph (a), may agree in writing either that the entire transaction shall be governed by Part 357 or that the entire transaction shall be governed by applicable Treasury regulations as in effect prior to adoption of Part 357.

(c) For transactions in securities that were issued prior to [the date which is 60 days after the date of publication of Subparts A, B, and D of this Part in final form] this Part supplements, amends, and modifies the regulations contained in Subpart O Department Circular No. 300, 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.

Sec. 357.2 Governing law.

(a) 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").

(b) 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, except as provided in paragraph (c) of this section.

(c) Notwithstanding paragraph (b) of this section, the rights and obligations, other than rights and obligations of the United States, arising out of interests in securities maintained on the books of a book-entry custodian at a place outside the United States, its territories or possessions are governed by applicable foreign law, if the business of such book-entry custodian conducted at such place is subject to the laws of a jurisdiction other than the United States, its territories or possessions, and such book-entry

custodian and its customer have not made a valid choice of applicable Federal law with respect to such securities.

Sec. 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 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.

"Clearing bank" means a depository institution, as defined below but excluding a depository institution described in subparagraph (g), which has a book-entry

securities account at a Federal Reserve Bank through which it provides clearing services.

"Clearing lien" means a security interest granted to a clearing bank or Federal Reserve Bank, pursuant to a written agreement, to secure credit extended in providing clearing services.

"Clearing services" means delivering and receiving securities and payments for securities on behalf of other persons.

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

"Depository institution" means an entity described in section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)). Under section 19(b) of the Federal Reserve Act, the term "depository institution" includes:

(a) Any insured bank as defined in 12 U.S.C. 1813 or any bank which is eligible to make application to become an insured bank under 12 U.S.C. 1815;

(b) Any mutual savings bank as defined in 12 U.S.C. 1813 or any bank which is eligible to make

application to become an insured bank under 12 U.S.C. 1815;

(c) Any savings bank as defined in 12 U.S.C. 1813 or any bank which is eligible to make application to become an insured bank under 12 U.S.C. 1815;

(d) Any insured credit union as defined in 12 U.S.C. 1752 or any credit union which is eligible to make application to become an insured institution under 12 U.S.C. 1781;

(e) Any member as defined in 12 U.S.C. 1422;

(f) Any insured institution as defined in 12 U.S.C. 1724 or any institution which is eligible to make application to become an insured institution under 12 U.S.C. 1726; and

(g) For the purpose of 12 U.S.C. 248(o), 342 to 347, 347c, and 372, any association or entity which is wholly owned by or which consists only of institutions referred to in paragraphs (a) through (d) of this definition.

"Entity" means any person except an individual.

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

"Financial institution" means, for purposes of direct deposit, an institution which has agreed to receive credit payments under 31 CFR Part 210, as amended from time to time, and has not withdrawn its participation in a direct deposit program under Part 210, or an institution which is willing to agree to receive credit payments under 31 CFR Part 210 and has enrolled with its Federal Reserve Bank.

"Incompetent" means an individual who is legally, medically or mentally incapable of handling his or her business affairs, except that a minor is not an incompetent solely because of age.

"Issue" means a group of securities, as defined in this section, that is identified by the same CUSIP number.

"Maturity value" is the amount that the Department is obligated to pay when a security matures.

"Minor" means an individual who is under the age of majority, as determined by applicable state law.

"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.

"Original issue" means the offering by the Department of the Treasury of a marketable Treasury security to the public and its issuance in book-entry accounts maintained either directly by the Treasury or held through a Federal Reserve Bank.

"Owner," as used in Subpart C, means the individual(s) or entity in whose name a security is registered. If a security is registered in more than one name, the term "owner" includes all those whose names appear on the registration and are authorized by this Part to make a transaction request on a security held in TREASURY DIRECT.

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

"Redemption" means payment of a security at maturity, or pursuant to a call for redemption in accordance with the terms of a security.

"Representative" includes an executor, administrator, legal guardian, committee, conservator, and any similar person or entity appointed by a court to represent the estate of a decedent, minor, or incompetent, as well as a trustee, whether appointed by a court or otherwise.

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

"Security" means a bond, note, or bill, each as defined in this section, and any other obligation issued by the Department that, by the terms of the applicable offering circular or announcement, is 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. A security shall be deemed a security for purposes of State law.

"Security agreement" means an agreement that creates 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.

"Taxpayer identifying number" or "TIN" means a social security account number or an employer identification number, as appropriate.

"TRADES" is the Treasury/Reserve Automated Debt Entry System.

"Transaction request" means a request to effect a change in an account master record or securities portfolio maintained in TREASURY DIRECT.

"Transaction request form" means a form or series of forms prescribed for use by the Department to request a transaction in TREASURY DIRECT. (This term includes a document that the Department has determined contains all of the elements required by the transaction request form.)

"TREASURY DIRECT" is the TREASURY DIRECT Book-Entry Securities System.

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

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

(a) Interest on securities maintained in TRADES shall be credited to such reserve or other account at a Federal Reserve Bank as is designated by the entity to whose securities account at such Federal Reserve Bank such securities have been credited.

(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, to such reserve or other account at a Federal Reserve Bank as is designated by the entity whose securities account at such Federal Reserve Bank was charged.

(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 in accordance with paragraph (a) or (b) of this section.

(d) Subject to any rights it may have as a secured party

under a written security agreement, a book-entry custodian that is maintaining securities on behalf of another person shall, upon receipt of any payment in accordance with paragraph (a) or (b) of this section 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.

Sec. 357.11 Rights acquired upon transfer and perfection.

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

(b) A transferee of a limited interest (including a security interest) in a security acquires rights only to the extent of the interest transferred and to the extent described in Section 357.13. The creation of a security interest as described in Section 357.13(a) or the termination of a security interest as described in Section 357.13(e) constitutes a transfer of a security interest for purposes of this paragraph.

Sec. 357.12 Transfers

(a) Transfer of a security or a limited interest (including

a security interest) in a security to a transferee occurs only:

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

(2) with respect to the transfer of a limited interest in accordance with Section 357.20(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 limited interest in favor of the transferee; or

(3) 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 or that otherwise permits identification of the transferee and the security transferred; or

(4) with respect to the transfer of a limited interest other than the transfer of a security interest as described in paragraph (a)(5) of this section, 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 limited interest in favor of the transferee; or

(5) with respect to the transfer of a security interest where the secured party is to be the book-entry custodian on whose books the interest of the transferor of the security interest appears, when both the security has been transferred to the transferor of the security interest in accordance with this section, and the transferor has executed a written security agreement with the book-entry custodian granting the book-entry custodian such security interest.

(b) By written agreement, a transferor and a transferee of a limited interest under paragraph (a)(4) or a security interest under paragraph (a)(5) of this section may place additional conditions on the transfer of such limited interest that delay the effectiveness of such transfer until such time as the specified conditions have been fulfilled. Notwithstanding any such conditions that may be agreed to as described in the preceding sentence, the book-entry custodian effecting a transfer under paragraph (a)(4) shall be entitled to treat the transfer as effective as to both the transferor and the transferee, unless the book-entry custodian is a party to such agreement.

(c) A transfer under paragraph (a)(3), (4), or (5) of this section is effective only if the security transferred or the security in which the limited interest is granted is part or all of an amount of securities of the same issue that (1)

are maintained at a Federal Reserve Bank in an account of the book-entry custodian effecting the transfer, or (2) is credited on the books of another book-entry custodian to an account of the book-entry custodian effecting the transfer and is maintained at a Federal Reserve Bank.

(d) For the purposes of this section, an entry is made if it is (1) in writing on tangible media, (2) displayable in writing (such as on a video screen) from data contained in or retrievable by electronic or other data processing equipment, or (3) convertible into either form within a reasonable time without undue delay or unreasonable expense.

(e) A security eligible to be maintained in TREASURY DIRECT under Section 357.1(a)(1) may be transferred from an account in TRADES to an account in TREASURY DIRECT in accordance with Section 357.22(a). A transfer of a security from TREASURY DIRECT to TRADES is effective when the book-entry custodian of the transferee designated on the transaction request form by the transferor makes an entry on its books that credits such security to a securities account maintained for the transferee or that otherwise permits identification of the transferee and the security transferred.

Sec. 357.13 Enforceability, perfection and termination of a security interest.

(a) A security interest 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.

(b) A security interest becomes perfected and enforceable against third parties at the time at which the security or security interest has been transferred to the secured party pursuant to Section 357.12 (a).

(c) Prior to the time a security interest becomes perfected in accordance with paragraph (b) of this section, if 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, a security interest is perfected and enforceable against third parties for a period of seven (7) calendar days from the date on which it became enforceable against the grantor 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 in this paragraph, the security interest becomes perfected in accordance with paragraph (b) of this section. If the security interest does not become perfected in accordance with paragraph (b) within the seven-day period, the security interest will become unperfected and unenforceable against third parties, but will continue to be enforceable between the secured party and the grantor of the security interest, until the time at which the transfer requirement of paragraph (b) has been complied with, and the security interest will be deemed to be perfected only as of such time.

(d) 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.

(e) A security interest in a security is terminated by (1) transfer of the security, by or with the agreement of the secured party, to the grantor of the security interest, a designee of the grantor, or any successor in interest of the grantor, (2) fulfillment of the obligation for which the security interest was granted, or (3) written release of the security interest signed by the secured party.

Sec. 357.14 Good faith transferee

(a) A good faith transferee is a transferee that acquired a security or a limited interest in a security for value, in good faith, and without notice of any adverse claim.

(b) Except as otherwise provided in Sections 357.15 and 357.19, a good faith transferee, in addition to acquiring rights in a security in accordance with Section 357.11, acquires its interest in the security free of any adverse claim which arose prior to the transfer of such interest to such transferee.

(c) An "adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(d) A transferee is a transferee for purposes of this section if:

(1) the transferee takes a security or a limited interest in a security by any voluntary transaction creating or granting an interest in a security, and not solely by operation of law; and

(2) such security or limited interest is transferred to the transferee in accordance with the provisions of

Section 357.12(a)(1), (a)(3) or (a)(5).

(e) Among transferees whose interests in securities are reflected on the books of the same book-entry custodian, the interests of the good faith transferees shall have priority over the interests of those who do not qualify as good faith transferees. In the event that the claims to securities of the same issue of those who qualify as good faith transferees exceed the aggregate amount of such securities available to satisfy their claims, the good faith transferees shall share ratably in the available securities of that issue.

(f) Notwithstanding Section 357.11, the transferee of a security or a limited interest that has been a party to any fraud or illegality affecting the security, or that as a prior transferee of the security had notice of an adverse claim, cannot improve its position by taking from a good faith transferee.

Sec. 357.15 Clearing lien priority

(a) A clearing lien in a security shall have priority over all other claims of third parties to that security including claims of a transferee that qualifies as a good faith transferee except that:

(1) all clearing liens are subject to any interests of the United States in the same security as provided in Section 357.19; and

(2) a clearing lien asserted by a clearing bank is subject to a clearing lien of a Federal Reserve Bank in the same security.

(b) A clearing lien qualifies for the priority provided under this section only to the extent of credit actually extended in performing clearing services and only if:

(1) the lien is perfected in accordance with Section 357.13(b); and

(2) the lien was acquired in good faith.

(c) A clearing lien may not be asserted by a clearing bank against securities which the clearing bank has segregated or otherwise identified on its own books as securities belonging to customers of a book-entry custodian for which the clearing bank provides clearing services, except where such customers have agreed in writing to permit use of their securities as collateral. A clearing lien may not be asserted by a Federal Reserve Bank against securities which are segregated on the books of the Federal Reserve Bank as securities belonging to customers of the depository

institution for which the Federal Reserve Bank provides clearing services except where such customers have agreed in writing to permit use of their securities as collateral.

Sec. 357.16 Duties of book-entry custodians.

(a) A book-entry custodian shall send to its customer confirmation of a transfer of a security to such customer under Section 357.12(a)(3) no later than the close of business on its next business day after the day on which the entry described in Section 357.12(a)(3) is made.

(b) A book-entry custodian shall send an acknowledgment of the transfer of a limited interest in accordance with Section 357.12(a)(4) to the transferor and to the transferee of such limited interest no later than the close of business on its next business day after the day on which the entry described in Section 357.12(a)(4) is made. If the transferee has not provided the book-entry custodian with its address, the acknowledgment required to be sent to the transferee shall be sent to the transferee at the address of the transferor.

(c) A book-entry custodian, upon receipt of an adequate request by a customer, shall provide a statement to such customer or a designee of such customer, of (1) the interest in such security of such customer and any other customer in

that same security, as such interests appear on the books of the book-entry custodian as of the date the request is received, and (2) any limited interest in favor of the book-entry custodian, or granted by the book-entry custodian to a third party, as of the date the request is received. For purposes of this paragraph, an adequate request is a request in writing, that provides the address to which a response is to be sent, and which is received at the department of the book-entry custodian that is responsible for maintaining the records of book-entry securities. For purposes of this paragraph, a customer of a book-entry custodian is any person whose interest in a security, including a limited interest, is recorded on the books of the book-entry custodian.

(d) Any confirmation, acknowledgment, or statement issued pursuant to this section must be delivered in writing or in such other form that at the option of the recipient may be reduced to writing.

(e) For purposes of this section, if any book-entry custodian is subject to a regulation of the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, or other Federal regulatory agency under which a book-entry custodian effecting a securities transaction for a customer is required to furnish to its customer a

confirmation or written notification of the transaction, then such book-entry custodian shall not be subject to the requirements of this section so long as it is in compliance with such regulation.

(f) A confirmation, acknowledgment, or statement required under this section may not be waived by the person entitled to receive it unless such waiver is specifically authorized by Federal regulation referred to in paragraph (e) of this section.

Sec. 357.17 Warranties

(a) In connection with any transfer of a security or an interest in a security in accordance with Section 357.12, a book-entry custodian warrants its good faith and authority. Such warranty of good faith and authority shall include, but shall not be limited to, (1) a warranty that the security described in any required confirmation is free of any lien, encumbrance, or claim, including any adverse claim of ownership, granted by the book-entry custodian except as specifically noted on the confirmation; (2) a warranty that, to the knowledge of the book-entry custodian, the security described in the confirmation is free of any other claims, except as specifically noted on the confirmation; and (3) a warranty that the security is part or all of an amount of the same security maintained in an account of the book-entry

custodian on the books of another book-entry custodian or on the books of a Federal Reserve Bank.

(b) A book-entry custodian that is also the transferor of the security or an interest in a security warrants to the transferee that the transfer is rightful and effective, in addition to the warranties described in paragraph (a) of this section.

(c) Any transferor of a security or an interest in a security, other than the United States, a Federal Reserve Bank, or a book-entry custodian, warrants to its transferee that the transfer is rightful and effective and that the transferor is acting in good faith.

(d) By providing a statement in accordance with Section 357.16(c) or pursuant to a similar requirement under other Federal regulation, a book-entry custodian warrants to its customer that the information provided therein is accurate.

(e) By sending a confirmation in accordance with Section 357.16(a) or pursuant to a similar requirement under other Federal regulation or an acknowledgment in accordance with Section 357.16(b), a book-entry custodian warrants to its transferee that the book-entry custodian has made an entry as described in Section 357.12(a)(3) or (4), as appropriate, or that such an entry will be made before the book-entry

custodian next opens for business.

(f) The warranties described in this section may not be disclaimed or limited by agreement.

Sec. 357.18 Duty to transfer.

(a) Unless otherwise agreed, a book-entry custodian fulfills its duty to transfer a security at the time (1) it makes an entry on its books or instructs another book-entry custodian to make such an entry in accordance with Section 357.12(a)(3); (2) it instructs a Federal Reserve Bank to make an entry in accordance with Section 357.12(a)(1); or (3) it instructs its book-entry custodian or Federal Reserve Bank to transfer the security to TREASURY DIRECT.

(b) Unless otherwise agreed, a transferor other than the United States, a Federal Reserve Bank, or a book-entry custodian fulfills its duty to transfer at the time it instructs its book-entry custodian, in the manner required by such book-entry custodian, (1) to make an entry on its books or instruct another book-entry custodian to make such an entry in accordance with Section 357.12(a)(3); (2) to instruct a Federal Reserve Bank to make an entry in accordance with Section 357.12(a)(1); or (3) to transfer the security to TREASURY DIRECT.

Sec. 357.19 Priority of interests of the United States

A limited interest in securities transferred to the United States or the Department to secure deposits of public money or deposits to the Treasury tax and loan accounts, or any other limited interest in favor of the United States that is required by Federal statute or regulation and is transferred to the United States 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. For purposes of this section, a security or a limited interest in a security is transferred to the United States if an entry is made in accordance with Section 357.12 identifying either the United States or any executive department thereof as the transferee.

Sec. 357.20 Authority of Federal Reserve Banks.

Each Federal Reserve Bank is hereby authorized as fiscal agent of the United States to issue securities offered and sold by the Department to which this Subpart applies, in accordance with the terms of the applicable offering circular and with procedures established by the Bureau of the Public Debt; to service and maintain such securities in securities accounts established

for such purposes; to make payments of principal and interest on such securities, as directed by the Department; and to effect transfer of securities between securities accounts as directed by the entities for which such securities accounts are maintained.

Sec. 357.21 Rights of the United States and Federal Reserve Banks with respect to transfers on Federal Reserve Bank records.

(a) A transfer of a limited interest on the books of a Federal Reserve Bank under Section 357.12(a)(2) 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 agreement with the Federal Reserve Bank on whose books the transfer is to be recorded. In the event that a limited interest is transferred on the books of a Federal Reserve Bank pursuant to Section 357.12(a)(2), that Federal Reserve Bank shall recognize the interest of the transferee only to the 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 transferee.

(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 transferee, as described in paragraph (a) of this section, a Federal Reserve Bank that has transferred a security or a limited 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

Sec. 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 surety, as may in the judgment of the Secretary be necessary for the protection of the interests of the United States.

Sec. 357.41 Waiver of regulations.

The Secretary reserves the right, 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.

Sec. 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 on a security 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 commotion, accident, computer or other equipment failure, or the failure or interruption of electrical power or of communications lines.

Sec. 357.43. Liability for transfers to and from TREASURY DIRECT.

A depository institution or other entity 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.

Sec. 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.

Sec. 357.45 Supplements, amendments or revisions.

The Secretary may, at any time, prescribe additional supplemental, amendatory or revised regulations with respect to securities, including charges and fees for the maintenance and servicing of securities in book-entry form.