Federal Register

Wednesday,
January 19, 2000

Part VII

Department of the Treasury

Fiscal Service

31 CFR Part 375

Marketable Treasury Securities Redemption Operations; Final Rule

DEPARTMENT OF THE TREASURY

Fiscal Service

31 CFR Part 375

Marketable Treasury Securities Redemption Operations

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

ACTION: Final rule.

SUMMARY: The Department of the Treasury (''Treasury,'' ''We,'' or ''Us'') is issuing rules in final form setting out the terms and conditions by which we may redeem outstanding, unmatured marketable Treasury securities. We are establishing a new part in the Code of Federal Regulations for this purpose. Redemption operations (''buybacks'') will help us better manage our financing needs, promote more efficient capital markets, and may lower financing costs for taxpayers.

EFFECTIVE DATE: January 19, 2000.

ADDRESSES: You may download this final rule from the Bureau of the Public Debt's Internet site at the following address: www.publicdebt.treas.gov. It is also available for public inspection and copying at the Treasury Department Library, Room 5030, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220. To visit the library, call (202) 622–0990 for an appointment.

FOR FURTHER INFORMATION CONTACT: Lori Santamorena (Executive Director) or Chuck Andreatta (Senior Financial Advisor), Bureau of the Public Debt, Government Securities Regulations Staff, (202) 691–3632.

SUPPLEMENTARY INFORMATION:

I. Background

The government's improved fiscal position has caused Treasury's borrowing needs to decline significantly, and we have been adjusting the government's borrowing program accordingly. Our adjustments to date have distributed the required cuts in market borrowing across all maturity areas. In this environment, we began examining the concept of purchasing outstanding Treasury securities in the market.

Buybacks will provide us with greater flexibility to manage the government's debt and to respond to our improved fiscal condition. First, buybacks will enhance market liquidity by allowing us to maintain regular issuances of new benchmark securities across the maturity spectrum, in greater volume than would otherwise be possible. Over the long term, this enhanced liquidity could reduce the government's interest expense and promote more efficient capital markets.

Second, buybacks will enhance our ability to exert greater control over the maturity structure of the outstanding debt. Without a buyback program, further reductions in Treasury new issue sizes and frequencies could be necessary. A buyback program, however, will provide us the option of managing the maturity structure of the debt by selectively targeting the maturities of debt to be repurchased.

Third, buybacks will provide an additional cash management tool, absorbing excess cash in periods when tax revenues usually exceed immediate spending needs.

In addition, although not a primary reason for conducting buybacks, we may occasionally be able to reduce the government's interest expense by purchasing ''off-the-run'' debt and replacing it with lower-yield ''on-the-run'' debt.[1]

On August 5, 1999 (64 FR 42626), we published proposed rules for public comment that laid out the proposed terms and conditions by which we would conduct buybacks. The closing date for comments was October 4, 1999. As explained in more detail below, after considering the comments provided, we have decided to adopt the proposed methodology for conducting buybacks.

II. Comments Received in Response to the Proposed Rule

We received 13 comment letters on the proposed rule[2]—five from securities firms, four from individuals, and one each from a major trade association, the Treasury advisory committee of a major trade association, a futures exchange, and a Federal Reserve Bank. Overall these commenters were supportive of the proposal. No commenters opposed the proposal. As explained below, the comments raised a series of policy or technical issues related to implementation.

A. *Debt Management Policy Issues*

Two commenters expressed concern that the budget accounting treatment of any premiums that Treasury would pay to buy back Treasury securities could limit the size of the buyback program. Both commenters suggested a budget accounting policy change—that these premiums be amortized over the remaining life of the security bought back.

We consider this issue to be outside the scope of these regulations, which set out the terms and conditions of redemption operations.

Several comment letters made recommendations on the scheduling of redemption operations. Two commenters wanted them to be held in conjunction with the regular Treasury quarterly refunding auctions in February, May, August, and November. Another commenter recommended that redemption operations be held close to auctions of Treasury securities of similar maturity, while another commenter suggested only a regular schedule of redemption operations. Two commenters preferred that redemption operations not be conducted near potential delivery dates for Treasury futures contracts.

Commenters recommended a variety of maturity ranges to buy back. For example, one commenter advocated that securities with 15 to 25 years remaining to maturity were the best candidates for the Treasury to purchase, while another commenter recommended that Treasury buy back debt within the two-year to five-year maturity range to minimize any effects on the average length of the debt outstanding. Another commenter suggested that Treasury avoid buying back those securities that are the ''cheapest-to-deliver'' for Treasury futures contracts.

Two commenters expressed concern about the effect that redemption operations may have on the remaining liquidity of off-the-run issues. Both suggested limiting redemption operations for a particular security to 10 percent of its outstanding amount. One of these commenters also suggested that at least $1 billion of a security always remain outstanding. On the other hand, one commenter advocated that ''issues with less than $2 billion outstanding should be removed from the market,'' while another commenter saw ''no reason to state a limit on the specific amount of any given security that the Treasury can purchase.''

The issues of the scheduling of redemption operations, the maturities to redeem, and the remaining supply of securities redeemed are not addressed in the final rule. For each operation we will first announce when the operation will occur and which maturity sector or sectors will be eligible for redemption. We will determine the amount of any particular security to redeem during the

[1] A Treasury security is ''on-the-run'' when it is the newest security issue of its maturity (*e.g.,* in October the two-year note issued September 30 would be on the run'' while the two-year note issued August 31 would be ''off-the-run''). An on-the-run security is normally the most liquid issue for that maturity.

[2] The comment letters are available for downloading on the Internet and for inspection and copying at the Treasury Department Library at the addresses provided earlier in this rule.

redemption operation consistent with our debt management goals.

B. Technical/Operational Issues

Two commenters recommended that we issue redemption operation announcements several days in advance of the redemption operations. They contended that a relatively long notice period would give securities dealers more time to prepare for the redemption operation, to canvass their customers to determine their levels of interest, and that it would aid price discovery. One commenter, however, preferred ''a relatively short lead time * * * , not unlike the process for a Federal Reserve coupon pass.''

We are not addressing the notice period in the final rule so that we can retain flexibility in the timing of announcements.

Opinion was fairly evenly divided on the issue of whether Treasury should announce the specific securities that are eligible for redemption or merely announce a particular range of maturities that will be purchased. Those who favored announcing specific issues primarily argued that this would help dealers add eligible securities to their inventories prior to the redemption operation. Commenters preferring announcing a range of securities contended that participants would have greater flexibility to decide which securities to offer, and Treasury would have greater flexibility to decide which securities to purchase. One commenter also predicted that announcing a maturity range would mitigate the ''announcement effect'' of the prices of specific issues increasing as a direct result of the announcement.

The announcement will provide the maturity sector or sectors that will be eligible for redemption. It will also provide descriptions of each security within those maturity sectors including the CUSIP number, interest rate, maturity date, and the amount outstanding.

One commenter recommended that we use a proprietary electronic system for processing offers different from the Federal Reserve Bank of New York's. We will use the Federal Reserve Bank of New York's system, however, because it is already in place at the location where offers will be received and it meets our processing needs.

Another commenter suggested that Treasury consider using a single-price rather than a multiple-price auction mechanism. This commenter suggested that submitters may make more aggressive offers in a single-price format.

Redemption operations will at least initially be a multiple-price process in which successful offerors will receive the price at which they offered securities. Multiple-price redemption operations will allow us to make immediate use of the Federal Reserve Bank of New York's electronic system for executing open market operations. At some future time, however, we might want to evaluate the potential merits of a single-price process.

One commenter noted that the proposed rule was silent on the length of time between the closing time for submission of offers and the time that confirmations will be provided to submitters. The commenter stressed that this time period should be as short as possible because of the submitting dealers' exposure to market risk during this timeframe.

We will provide confirmations (results messages) to submitters, and issue a redemption operation results press release, as quickly as possible following the deadline for submitting offers.

In the preamble to the proposed rule, we indicated that settlement would occur on the day after the redemption operation in conformance with the market's next-day settlement convention for other Treasury securities transactions. We specifically requested comment, however, on settlement-related issues. Two commenters recommended that there be at least two days between a redemption operation and settlement, primarily to inform any customers that their offers had been accepted and to facilitate timely delivery of customer securities. Another commenter specifically urged a three-day settlement timeframe because that is the settlement standard for corporate debt.

We will initially provide a minimum of two days between a redemption operation and settlement. This timeframe, however, is not stated in the final rule. Rather, the redemption operation and settlement dates will be provided in the redemption operation announcement.

We also received a comment that the definition of ''accrued interest'' should be revised to clarify that the time period covered in the accrued interest calculation includes the settlement date. We agree with this recommendation.

One comment letter expressed confusion over whether participation in redemption operations would be voluntary and concern that the Treasury might purchase, or a securities dealer might offer to sell, a Treasury security without the permission of its owner.

In response, we want to emphasize that participation in a Treasury redemption operation will be entirely voluntary and that securities industry rules for dealing fairly with customers prohibit securities dealers from conducting unauthorized customer transactions.

Finally, one comment letter consisted of a series of questions regarding various aspects of the redemption program, but made no recommendations.

III. Changes From the Proposed Rule

After taking the comments we received into consideration, we are adopting this final rule setting out the terms and conditions by which we may redeem outstanding, unmatured marketable Treasury securities. The final rule adopts the proposed rule without significant changes. The only changes that have been made are in the definitions of ''Accrued interest,'' ''Price,'' and ''Privately held amount'' (§ 375.2), and in the descriptions of the redemption operation announcement (§ 375.10), how to submit an offer (§ 375.12), and who is responsible for delivering securities (§ 375.15).

The description of the redemption operation announcement was revised to add the range of maturities of eligible securities as one of the details that we will provide.

The description of how to submit an offer was revised to provide us greater flexibility in which electronic system we will use for receiving offers. The proposed rule specified the Federal Reserve Bank of New York's Trading Room Automated Processing System (TRAPS) as the system through which submitters must submit offers. While TRAPS is the system through which submitters will submit offers, eliminating specific mention of this system in the final rule allows for a different system to be used at some future date.

The description of who is responsible for delivering securities was revised to clarify that submitters are responsible for delivering all securities we accept in a redemption operation, including any securities for which they submitted offers on behalf of others.

In addition, we eliminated the paragraphs on the maximum amount offered (§ 375.13) and deliveries of definitive securities (§ 375.23). We removed the limit on the maximum amount of a particular security that a submitter may offer because it is not necessary operationally. The Federal Reserve Bank of New York's electronic system will accept the correct amount of an offer, even if the offer exceeds the security's amount outstanding.

We eliminated the paragraph that would have permitted deliveries of definitive securities because developing a process for timely definitive deliveries would have been too complex operationally in relation to any participation we might expect from holders of definitive securities. Relatively few Treasury securities continue to be held in definitive form. Those still holding definitive securities can easily convert them to book-entry securities if they wish to participate in any future redemption operations.

A summary of the main features of the final rule that remain unchanged from the proposed rule are:

(1) We will issue an announcement of an upcoming redemption operation, including the expected maximum amount of the operation;

(2) Offers will be competitive, on the basis of price, to three decimals;

(3) Redemption operations will be a multiple-price process in which successful offerors receive the price at which they offered securities;

(4) Only primary dealers as designated by the Federal Reserve Bank of New York will be allowed to submit offers for themselves or others, enabling use of the Bank's existing electronic systems; and

(5) There will be no limits on the number of offers per security or on the total number of offers from a particular submitter.

IV. Procedural Requirements

This final rule is not a ''significant regulatory action'' under Executive Order 12866. Although we issued this rule in proposed form to benefit from public comment, the notice and public procedures and delayed effective date requirements of the Administrative Procedure Act do not apply, under 5 U.S.C. 553(a)(2).

Since no notice of proposed rulemaking was 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 375

Bonds, Federal Reserve System, Government securities, Securities.

For the reasons stated in the preamble, part 375 is added to 31 CFR chapter II to read as follows:

PART 375—MARKETABLE TREASURY SECURITIES REDEMPTION OPERATIONS

Subpart A—General Information

Sec.

375.0 What authority does the Treasury have to redeem its securities?
375.1 Where are the rules for the redemption operation located?
375.2 What special definitions apply to this rule?
375.3 What is the role of the Federal Reserve Bank of New York in this process?

Subpart B—Offering, Certifications, and Delivery

375.10 What is the purpose of the redemption operation announcement?
375.11 Who may participate in a redemption operation?
375.12 How do I submit an offer?
375.13 What requirements apply to offers?
375.14 Do I have to make any certifications?
375.15 Who is responsible for delivering securities?

Subpart C—Determination of Redemption Operation Results; Settlement

375.20 When will the Treasury decide on which offers to accept?
375.21 When and how will the Treasury announce the redemption operation results?
375.22 Will I receive confirmations and, if I am submitting offers for others, do I have to provide confirmations?
375.23 How does the securities delivery process work?

Subpart D—Miscellaneous Provisions

375.30 Does the Treasury have any discretion in this process?
375.31 What could happen if someone does not fully comply with the redemption operation rules or fails to deliver securities?

Authority: 5 U.S.C. 301; 31 U.S.C. 3111; 12 U.S.C. 391.

Subpart A—General Information

§ 375.0 What authority does the Treasury have to redeem its securities?

Section 3111 of Title 31 of the United States Code authorizes the Secretary of the Treasury to use money received from the sale of an obligation and other money in the general fund of the Treasury to buy, redeem, or refund, at or before maturity, outstanding bonds, notes, certificates of indebtedness, Treasury bills, or savings certificates of the United States Government. For the purposes of this part, we will refer to these outstanding obligations as ''securities.''

§ 375.1 Where are the rules for the redemption operation located?

The provisions in this part and the redemption operation announcement govern the redemption of marketable Treasury securities under 31 U.S.C. 3111. (See § 375.10.)

§ 375.2 What special definitions apply to this rule?

The definitions in 31 CFR part 356 govern this part except as follows:

Accrued interest means an amount payable by the Treasury as part of the settlement amount for the interest income earned between the last interest payment date up to and including the settlement date.

Bank means the Federal Reserve Bank of New York.

Customer means a person or entity on whose behalf a submitter has been directed to submit an offer of a specified amount of securities in a specific redemption operation.

Minimum offer amount means the smallest par amount of a security that may be offered to the Treasury. We will state the minimum offer amount in the redemption operation announcement.

Multiple means the smallest additional par amount of a security that may be offered to the Treasury. We will state the multiple in the redemption operation announcement.

Offer means an offer to deliver for redemption a stated par amount of a specific security to the Treasury at a stated price.

Price means the dollar amount to be paid for a security expressed as a percent of its current par amount.

Privately held amount means the total amount outstanding of a security less holdings of the Federal Reserve System and Federal Government accounts.

Redemption amount means the maximum par amount of securities that we are planning to redeem through a redemption operation. We will state the redemption amount in the redemption operation announcement.

Redemption operation means a competitive process by which the Treasury accepts offers of marketable Treasury securities that by their terms are not immediately payable.

Security means an outstanding unmatured obligation of the United States Government that the Secretary is authorized to buy, redeem or refund under section 3111 of Title 31 of the United States Code.

Settlement means full and complete delivery of and payment for securities redeemed.

Settlement amount means the par amount of each security that we redeem, multiplied by the price we accept in a redemption operation, plus any accrued interest.

Settlement date means the date specified in the redemption operation announcement on which you must deliver a security to the Treasury for payment.

Submitter means an entity submitting offers directly to the Treasury for its own account, for the account of others, or both. (See § 375.11(a).)

Tender means a computer transmission or document submitted in a redemption operation that contains one or more offers.

We (''us'') means the Secretary of the Treasury and his or her delegates, including the Treasury Department, the Bureau of the Public Debt, and their representatives. The term also includes the Federal Reserve Bank of New York, acting as fiscal agent of the United States.

You means a prospective submitter in a redemption operation.

§ 375.3 What is the role of the Federal Reserve Bank of New York in this process?

As fiscal agent of the United States, the Federal Reserve Bank of New York performs various activities necessary to conduct a redemption operation under this part. These activities may include but are not limited to:

(a) Accepting and reviewing tenders;

(b) Calculating redemption operation results;

(c) Issuing notices of redemptions;

(d) Accepting deliveries of Treasury securities at settlement; and

(e) Processing the Treasury payment for securities delivered at settlement.

Subpart B—Offering, Certifications, and Delivery

§ 375.10 What is the purpose of the redemption operation announcement?

We provide public notice that we are redeeming Treasury securities by issuing a redemption operation announcement. This announcement lists the details of each proposed redemption operation, including the maximum redemption amount, the range of maturities of eligible securities, descriptions of the securities that fall within that maturity range, and the redemption operation and settlement dates. The redemption operation announcement and this part specify the terms and conditions of a redemption operation. If anything in the redemption operation announcement differs from anything in this part, the redemption operation announcement will apply. Accordingly, you should read the applicable redemption operation announcement along with this part.

§ 375.11 Who may participate in a redemption operation?

(a) *Submitters.* To be a submitter, you must be an institution that the Federal Reserve Bank of New York has approved to conduct open market transactions with the Bank.

(b) *Others.* A person or entity other than a submitter may participate only if it arranges to have an offer or offers submitted on its behalf by a submitter.

§ 375.12 How do I submit an offer?

As a submitter, you must submit an offer in a tender to the Treasury via the Federal Reserve Bank of New York. You must submit any tenders in an approved format and the Bank must receive them prior to the closing time stated in the redemption operation announcement. If we do not receive your tenders timely, we will reject them. Your tenders are binding on you after the closing time specified in the redemption operation announcement. You are responsible for ensuring that we receive your tenders on time. We will not be responsible in any way for any unauthorized tender submissions or for any delays, errors, or omissions in submitting tenders.

§ 375.13 What requirements apply to offers?

(a) *General.* You may only submit competitive offers (specifying a price). All offers must state the security description, par amount, and price of each security offered. All offers must equal or exceed the minimum offer amount, and be in the multiple, stated in the redemption operation announcement.

(b) *Price format.* You must express offered prices in terms of price per $100 of par with three decimals, *e.g.,* 102.172. The first two decimals represent fractional 32nds of a dollar. The third decimal represents eighths of a 32nd of a dollar, and must be a 0, 2, 4, or 6. For example, an offer of 102.172 means one hundred two and seventeen 32nds and two eighths of a 32nd, or in decimals, 102.5390625.

(c) *Maximum number of offers.* There is no limit on the number of offers you may make for each eligible security. There is also no limit on the number of eligible securities you may offer.

§ 375.14 Do I have to make any certifications?

By submitting a tender offering a security or securities for sale, you certify that you are in compliance with this part and the redemption operation announcement.

§ 375.15 Who is responsible for delivering securities?

As a submitter, you are responsible for delivering any securities we accept in the redemption operation, including any securities for which you submitted offers on behalf of others. (See § 375.23.) All securities you deliver must be free and clear of all liens, charges, claims, and any other restrictions.

Subpart C—Determination of Redemption Operation Results; Settlement

§ 375.20 When will the Treasury decide on which offers to accept?

We will determine which offers or portions of offers to accept after the closing time for receipt of tenders. All such determinations will be final.

§ 375.21 When and how will the Treasury announce the redemption operation results?

We will make an official announcement of the redemption operation results through a press release. For each security we redeem, the press release will include such information as the amounts offered and accepted, the highest price accepted, and the remaining privately held amount outstanding.

§ 375.22 Will I receive confirmations and, if I am submitting offers for others, do I have to provide confirmations?

(a) *Confirmations to submitters.* We will provide a confirmation of acceptance or rejection in the form of a results message to submitters of offers by the close of the business day of the redemption operation.

(b) *Confirmation of customer offers.* If you submit a successful offer for a customer, you are responsible for notifying that customer of the impending redemption.

§ 375.23 How does the securities delivery process work?

If any of the offers you submitted are accepted, you must transfer the correct book-entry Treasury securities in the correct par amount against the correct settlement amount on the settlement date. You must deliver the securities to the account specified in the redemption operation announcement.

Subpart D—Miscellaneous Provisions

§ 375.30 Does the Treasury have any discretion in this process?

(a) We have the discretion to:

(1) Accept or reject any offers or tenders submitted in a redemption operation;

(2) Redeem less than the amount of securities specified in the redemption operation announcement;

(3) Add to, change, or waive any provision of this part; or

(4) Change the terms and conditions of a redemption operation.

(b) Our decisions under this part are final. We will provide a public notice if we change any redemption operation provision, term or condition.

§ 375.31 What could happen if someone does not fully comply with the redemption operation rules or fails to deliver securities?

(a) *General.* If a person or entity fails to comply with any of the redemption operation rules in this part, we will consider the circumstances and take what we deem to be appropriate action. This could include barring the person or entity from participating in future redemption operations under this part and future auctions under 31 CFR part 356. We also may refer the matter to an appropriate regulatory agency.

(b) *Liquidated damages.* If you fail to deliver securities on time, we may require you to pay liquidated damages of up to 1% of your projected settlement amount.

Dated: January 13, 2000.

Donald V. Hammond,

Fiscal Assistant Secretary.

[FR Doc. 00–1250 Filed 1–18–00; 8:45 am]

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