§ 357.43 Liability for transfers to and from Legacy Treasury Direct®.

A depository institution or other entity that transfers to, or receives, a security from Legacy 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 for any claim, liability, or loss resulting from the transaction.

§ 357.44 [Reserved]

§ 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.

APPENDIX A TO PART 357—DISCUSSION OF FINAL RULE

BACKGROUND

Twenty-four written comments were received to the notice of proposed rulemaking from various sources, including Federal agencies, trade associations, as well as financial and commercial investment institutions. With the exception of one bank, all commentators endorsed the concept of a certificateless security. The grouping and identification of the comments received have been made on a section-by-section basis, with an explanation of the action taken with respect thereto. As circumstances necessitated the publication of the rule in two segments, in order to make each part more understandable, certain definitions, such as those for “Department” and “securities”, have appeared in the proposed rule for both Legacy Treasury Direct® and TRADES, and were slightly modified in the proposed rules on TRADES. Because these modifications represent non-substantive clarifications, and to avoid confusion as between the two portions of the rules, the definitions as used in TRADES have been adopted.
Legacy Treasury Direct registered in this form will be transferable upon the written request of either coowner. Other changes in the account may also be made upon the request of both parties to conduct any authorized transaction. While this form of registration will facilitate the receipt of payments and provide ease in conducting transactions, care should obviously be exercised in designating both parties to conduct any authorized transaction.

"Beneficiary form. The beneficiary form, i.e., "A payable on death to (POD) B," will permit the owner to have sole control of the account during his/her lifetime, but in the event of death, the account will pass by right of survivorship to the beneficiary."

One commentator questioned the "natural guardian" and "voluntary guardian" forms of registration provided in the regulations, pointing out that financial institutions are reluctant to establish an account in the name of a natural guardian of a minor because of the uncertainties as to who might be entitled to the funds on the death of the natural guardian or minor, or when the minor reached majority. It was mentioned that a bank would be reluctant to open an account in the name of a voluntary guardian, or to release funds from an existing account to a voluntary guardian because of the potential risk in the event of a claim from a court-appointed guardian. It seems apparent that the comment was prompted by the provision that appeared in the proposed rule that the account held in Legacy Treasury Direct and the deposit account to which payment is to be directed should be in the same form. As hereafter pointed out in the discussion under the payment section, this is not a requirement.

While parents are universally recognized as the natural guardians of the person of minors, they have generally not been recognized as entitled to control the estates of these minors, except perhaps in the case of small amounts. Traditionally, the guardian of the estate of a minor involves judicial appointment and supervision. In order to provide a means of dealing with the problem of disposing of securities inadvertently registered in the name of minors without requiring the appointment of a legal guardian and to provide a means for investing funds of a minor, which did not technically qualify for investment under the Uniform Gifts to Minors Act, the Department decided to provide recognition for natural guardians.

The voluntary guardianship procedure is wholly a creature of the Department's regulations. It was established in recognition of the burden placed on an incompetent’s estate and his/her family by requiring the appointment of a legal guardian to receive the interest on, or to redeem securities for, the account of an individual who has become incompetent, at least where the incompetent’s estate is relatively modest. This form of registration is not available on original issue and is limited to an aggregate of $20,000 (par amount) of Legacy Treasury Direct securities. The $20,000 limit in connection with the use of the voluntary guardianship procedure is in keeping with the limits used in connection with the summary administration of decedents’ estates under the laws of many States.

No comments were received regarding the provisions on judicial proceedings. Given their importance, the discussion that accompanied the publication thereof in proposed form is included here.

Judicial proceedings. Under the principle of sovereign immunity, neither the Department nor a Federal Reserve Bank, acting as fiscal agent of the United States, will recognize a court order that attempts to restrain or enjoin the Department or a Federal Reserve Bank from making payment on a security or from disposing of a security in accordance with instructions of the owner as shown on the Department’s records.

"The Department will recognize a final court order affecting ownership rights in Legacy Treasury Direct securities provided that the order is consistent with the provisions of subpart C and the terms and conditions of the security, and the appropriate evidence, as described in §357.23(c), is supplied to the Department. For example, the Department may recognize final orders arising from divorce or dissolution of marriage, creditor or probate proceedings, or cases involving application of a State slayer’s act. The Department will also recognize a transaction request submitted by a person appointed by a court and having authority under an order of a court to dispose of the security or payment with respect thereto, provided conditions similar to those above are met."

Section 357.25 Security interests.

Legacy Treasury Direct is not designed to reflect or handle the various types of security interests that may arise in connection with a Treasury bond, note or bill. However, the Treasury has from time to time and to a limited extent held in safekeeping, for such agencies as the Customs Service and Immigration and Naturalization Service, Treasury securities submitted in lieu of surety bonds in accordance with 31 U.S.C. 9205. While the Federal Reserve Banks handle the majority
of such pledges and will continue to do so, as this statute requires the Treasury to accept these Government obligations so pledged, a provision has been added for accepting and holding book-entry securities submitted for such purposes.

Section 357.26 Payments.

(a) General. Most comments focused on the provisions on payments. A key feature of Legacy Treasury Direct will be the making of payments by the direct deposit method (also known as the electronic funds transfer or ACH method). Checks will be issued only under extraordinary circumstances. A number of comments endorsed the concept of payment by direct deposit as an improvement given the difficulties associated with checks.

One comment expressed concern as to who would bear the burden of resolving errors in cases where a receiving financial institution fails to properly credit a payment. The Department has concluded that while the direct deposit payment method is not without risks, it is far superior to the use of checks, in terms of the risks, potential losses, and costs. In a case where a receiving institution fails to act in accordance with the instructions given it, the Bureau intends to use its best efforts to assist investors in rectifying the error.

(b) Direct deposit. A number of comments expressed the view that the Legacy Treasury Direct payment system should adopt either the rules governing the direct deposit of Government payments (31 CFR part 210), or the rules of the National Automated Clearing House Association ("NACHA Rules"), but not separate rules. The final rules have adopted some of the existing practices applicable to commercial ACH payments, but it is not possible for the Department of the Treasury to conform to all of these rules. For example, the Treasury has no authority to indemnify recipients of direct deposit payments, although such indemnification by a sender is contemplated in the NACHA rules and was advocated in several comments. It should also be noted that the rules applicable to Legacy Treasury Direct payments are modeled, to some extent, on the rules for Government direct deposit payments in order to take advantage of the large number of entities that are a part of the Government direct deposit network. See the discussion under paragraph (b)(2). Where there are unique rules applicable to Legacy Treasury Direct, however, they are explained below.

Given the variance between the procedures set out in the proposed rules and existing practice, and the increased burdens resulting therefrom, several clearing house associations and financial institutions requested that the implementation of Legacy Treasury Direct be delayed from July 1986 to July 1987. The Treasury is satisfied that the added burdens that would have been imposed on financial institutions to receive Legacy Treasury Direct payments under the proposed rules have been effectively eliminated in the final rule. Thus, Treasury plans to implement the system on or about the original target date. The final rules are being published, however, in advance of actual implementation so as to give financial institutions an opportunity to make whatever remaining, minor procedural changes as may be necessary.

(b)(1) Information on deposit account at financial institution. The proposed regulations provided that the owner of a security in Legacy Treasury Direct, or in the case of ownership by two individuals, the first-named owner, must be an owner of, and so designated, on the account at the receiving financial institution. The regulations also provided that in any case in which a security is held jointly or with right of survivorship, the account at the financial institution should be established in a form that assures that the rights of each joint owner or survivor will be preserved.

The rule requiring the naming of the first-named owner on the receiving financial institution account was based on tax reporting considerations. It has now been determined that the first-named security owner need not be named on the receiving deposit account.

The rule relating to establishment of the receiving account in joint ownership cases in the same form as the registration of the security was intended to be a notice to investors of a potential problem, rather than a requirement. In cases where an investor intends a beneficiary, joint owner or coowner to receive securities after the investor’s death, this intention may be defeated if the recipient is not also named on the receiving deposit account. It is up to the investor to examine his or her particular circumstances and determine whether the form in which the deposit account will be held is satisfactory. This matter has been clarified in paragraph (b)(1)(ii) of the final rule.

Except for the restriction described in paragraph (b)(1)(ii) (see below), the Treasury does not intend to establish any limitations on how the receiving deposit account is held.

Several comments addressed the issue of the registration of the security versus the title of the deposit account. Two comments pointed out that if the deposit account must be in the same form as the registration of the security, then existing traditional forms of ownership for bank accounts, which do not include all the forms of registration for securities held in Legacy Treasury Direct, would not suffice. Concerns were also expressed that with multiple forms of ownership, financial institutions could become involved in disputes with investors. As noted above, there is no requirement that the Legacy Treasury Direct account and the deposit account be identical. The responsibility to
choose the title of the deposit account rests with the investor.

Another comment objected to the rule that the first-named security owner be named on the deposit account because the rule would eliminate the possibility of payment to an account at a financial institution in the name of a mutual fund, security dealer, or insurance company. Although the change in the tax reporting rule described above permits payment to such accounts, as well as to trust accounts, since it appears that there is a question as to the capability of some receiving institutions to handle such payments, investors are strongly urged to consult their financial institution before requesting such payment arrangements. See paragraph (b)(1)(iii).

It should be emphasized that any payments that must be made by check will be made in the form in which the Legacy Treasury Direct account is held, which may be different than the form of the deposit account. Investors should be aware that this may result in checks being issued, and thus payment being made, in a form different than they intended the direct deposit payments to be. For example, if Investor A purchases a security in his or her name alone with instructions that payments be directed to a financial institution for the account of a money market fund, any checks that must be issued will be drawn in the name of Investor A. This could happen if Investor A furnishes erroneous payment instructions and the problem cannot be resolved before a payment date, in which case a check would be issued.

The one restriction on the form of the deposit account that appears in paragraph (b)(1)(ii) of the final regulations is a rule that where the Legacy Treasury Direct account is held, which may be different than the form of the deposit account, Investors should be aware that this may result in checks being issued, and thus payment being made, in a form different than they intended the direct deposit payments to be. For example, if Investor A purchases a security in his or her name alone with instructions that payments be directed to a financial institution for the account of a money market fund, any checks that must be issued will be drawn in the name of Investor A. This could happen if Investor A furnishes erroneous payment instructions and the problem cannot be resolved before a payment date, in which case a check would be issued.

The proposed rule provided in §357.26(b)(1)(iii) that the designation of a financial institution by a security owner to receive payments from Legacy Treasury Direct would constitute the appointment of the financial institution as agent for the owner for the receipt of payments. The crediting of a payment to the financial institution for deposit to the owner’s account, in accordance with the owner’s instructions, would discharge the United States of any further responsibility for the payment. One comment noted that, in contrast, the rule in 31 CFR 210.13 for Federal recurring payments is that the United States is not acquitted until the payment is credited to the account of the recipient on the books of a financial institution.

Although, in principle, the same rules should apply to all Government payments, the proposed Legacy Treasury Direct rule has been retained in the final regulations on the basis of the major differences in the procedures to be used in Legacy Treasury Direct. Most significantly, the Treasury will not be securing any written verification (i.e., an enrollment form) from a financial institution in account number and other payment information. As is now the practice in the case of payments under 31 CFR part 210. Under these circumstances, the Treasury cannot, in effect, guarantee that a payment will be credited by a financial institution to the correct account. It should also be noted that this rule on acquittance of the United States is consistent with the provision in §357.10(c) of the proposed regulations on TRADES. In practice, however, the Treasury plans to participate actively in seeking to locate and recover any payments that have been misdirected.

(b)(2) Agreement of financial institution. The proposed rule provided, in §357.26(b)(2), that a financial institution which has agreed to accept payments under 31 CFR part 210 shall be deemed to have agreed to accept payments from Legacy Treasury Direct. The
rule further provided that an institution could not be designated to receive Legacy Treasury Direct payments unless it had agreed to accept direct deposit payments under 31 CFR part 210.

One financial institution commented that a receiving institution that has already agreed to accept part 210 payments should have the choice as to whether to accept payments from Legacy Treasury Direct. The basis for this comment was the perception that the receipt of Legacy Treasury Direct payments would require the implementation of special procedures by the financial institution and expose it to additional risks. As explained earlier, the Treasury has significantly modified the procedures and reduced the requirements imposed upon a financial institution in order to receive Legacy Treasury Direct payments, and decreased as well the risks an institution will incur in the receipt of such payments. Thus, the proposed rule on eligibility of receiving institutions has been retained in the final rule in essentially the same form.

Two other comments were made to the effect that the category of institutions receiving payments should be broadened. In deciding to authorize payments to all institutions receiving part 210 payments, the Treasury considered the fact that many more institutions are designated endpoints for Government (direct deposit) payments than for commercialACH payments. In order to afford investors the widest choice of recipient institutions, all institutions that had agreed to accept part 210 payments were designated as authorized recipients. Treasury has now broadened the rule further to also authorize those financial institutions that are willing to agree to accept part 210 payments in the future. This rule will permit investors to designate institutions that are not now receiving Government direct deposit payments as the recipients of their Legacy Treasury Direct payments if the institutions make appropriate arrangements with the Federal Reserve Bank of their District.

(b)(3) Pre-notification. A significant feature of the Legacy Treasury Direct payment procedure will be the use of a pre-notification message sent to the receiving financial institution in advance of the first payment. This procedure, already in use for commercial ACH payments, alerts the institution that a payment will be made and provides an opportunity for verification of the accuracy of the account information.

The proposed regulations provided that the financial institution would be required to reject the pre-notification message within four calendar days after the date of receipt if the information contained in the message did not agree with the records of the institution or if for any other reason the institution would not be able to credit the payment. The rules also stated that a failure to reject the message within the specified time period would be deemed an acceptance of the pre-notification and a warranty that the information in the message was accurate.

Because there was some confusion over when the pre-notification message would be sent, the final rules clarify, in paragraph (b)(3)(i), that in most cases, this will occur shortly after establishment of a Legacy Treasury Direct account. The Treasury has under consideration a system change that would permit a second pre-notification to be sent closer to the time of the payment if the first payment is to occur a substantial length of time after account establishment.

One of the items of information contained in a pre-notification message is the name the investor has indicated appears on the deposit account. Comments were received that existing procedures and software do not permit automatic verification of the account name. Although there is apparently some variation in practice, and some institutions undertake to verify the account name information manually, the Treasury has decided to drop the account name verification requirement in the final rules. This means that under paragraph (b)(3)(i), a financial institution need only verify the account number and type designations on the pre-notification message. However, the Treasury urges institutions which are able to verify account names to do so and encourages the development of software that would have this capability.

A number of comments urged that the four-day period provided for an institution to reject a pre-notification message be lengthened. After consideration of the various alternatives proposed, the Treasury has concluded that an eight-day period will meet the needs of most institutions. See paragraph (b)(3)(ii) of the final rule. In responding to a pre-notification message, an institution may use the NACHA’s “notification of change” procedure, standardized automated rejection codes, or any other similar standard procedure. Upon receipt of such notification, the Treasury will either make the necessary changes in the Legacy Treasury Direct account or contact the investor, depending on the circumstances.

One commentator objected to the warranty by the receiving institution as to the accuracy of the pre-notification information, particularly in view of the manual verification or changes in procedures that would be required, and the resulting possibility of error. As previously noted, the requirement to verify an account name has been eliminated. In addition, language has been added to make it clear that the verification is limited to the time of pre-notification. The Treasury is of the view that the warranty is a useful concept in encouraging institutions to respond to pre-notification messages and will
benefit all concerned by increasing the like-
lihood that payments will be made accu-
rately and to the appropriate party.

(b)(5) Responsibility of financial institution.
The proposed regulations, in §357.26(b)(5)(ii), that a financial institution
receives a Legacy Treasury Direct pay-
ment on behalf of a customer would be re-
quired to promptly notify the Treasury when
it has made a change in the status or owner-
ship of the customer’s deposit account, such
as the deletion of the first-named owner of
the security from the title of the account, or
when the institution is on notice of the
death or incompetency of the owner of the
deposit account.

Several financial institutions objected to
this requirement on the grounds that it
would be burdensome and would require
the development of new procedures to monitor
the changes in deposit accounts. Specifi-
cally, several institutions indicated they
would be unable to relate the receipt of Leg-
acy Treasury Direct payments, which would
be handed in a centralized area of the insti-
tution, to the changes being made in a de-
posit account, which are handled in another
operational area of the institution. These in-
istitutions said they would not necessarily be
aware of who is the first-named owner of the
security in Legacy Treasury Direct, and that
more responsibility should be placed on the
security owner in reporting changes.

In response to these comments, the Treas-
ury has narrowed the notification rule, in
paragraph (b)(5)(ii) of the final rule, to re-
quire a financial institution to notify Legacy
Treasury Direct only in cases where it is on
notice of the death or legal incapacity of an
individual named on the deposit account, or
where it is on notice of the dissolution of a
corporation named in the deposit account.
Upon receipt of notice by the area of the in-
istitution that receives credit payments, the
institution will be required to return any
Legacy Treasury Direct payments received
thereafter.

(b)(6) Payments in error/duplicate payments.
The proposed regulations, in §357.26(b)(6), set
out rules describing the procedure that
would be followed in cases where the Treas-
ury or a Federal Reserve Bank has made
a duplicate payment or a payment in error.
First, the financial institution to which the
payment was directed would be provided
with a notice asking for the return of the
amount of the payment remaining in the de-
posit account. If the financial institution
were unable to return any part of the pay-
ment, it would be required to notify the
Treasury or its Federal Reserve Bank, and
provide the names and addresses of the per-
sons who withdrew funds from the deposit
account after the date of the duplicate pay-
ment or the payment in error. If the finan-
cial institution did not respond to the notice
within 30 days, the financial institution’s ac-
count at its Federal Reserve Bank could be
debited in the amount of the duplicate or im-
proper payment.

Several institutions raised objections
about various aspects of the above proce-
dures. One stated that 30 days was an insuffi-
cient time to respond and urged conformity
with the rules in 31 CFR part 210 permitting
a 60-day response time. Several objected in
principle to the provision author-
izing the debiting of their accounts. Several
comments indicated that if a payment is re-
turned by a financial institution using an
automated payment reversal procedure, then
only the full amount of the payment (not a
partial amount) can be reversed.

In the final rule, the Treasury has clarified
the procedures. The requirement to provide
the names of persons who withdrew funds
from an account has been changed. In para-
graph (b)(6)(i), financial institutions are
asked to provide only such information as
they have about the matter. The debiting of
an institution’s account at a Federal Reserve
Bank is intended to be simply a last resort if
the institution fails totally to respond to the
notice of a duplicate payment or payment
made in error. See paragraph (b)(6)(iii). The
time provided for response to this notice has
been lengthened to 60 days.

The final rule has also been clarified in
paragraph (b)(6)(i) to provide that the am-
ount that should be returned is an
amount equal to the payment. The Treasury
reserves the right, however, to request the
return by other than automated means of a
partial amount of a payment made in error.
It is anticipated that such a procedure would
occur only if the notice of a payment made
in error is not issued immediately after the
payment was made.

(d) Handling of payments by Federal Reserve
Banks. Some of the comments raised a ques-
tion about the liability of the Federal Re-
serve Banks in making payments. The pro-
posed rule, in §357.26(d)(2), provided that
each Federal Reserve Bank would be respon-
sible only to the Department and would not
be liable to any other party for any loss re-
sulting from its handling of payments. This
rule was taken from the existing regulations
in 31 CFR part 210 (see §210.3(f)), and is sim-
ply a restatement of existing law.

In making payments, the Federal Reserve
Banks are acting in the capacity as fiscal
agents of the United States, pursuant to 12
U.S.C. 361. They are not acting in an indi-
vidual (banking) capacity. If a Federal Re-
serve Bank misdirects a payment contrary
to instructions provided by the investor, the
United States, as principal, may remain lia-
able to the investor for the payment. The
United States could seek to recover any loss
from its agent, the Federal Reserve Bank.
However, because the proposed rule simply
stated a legal conclusion and tended to create the impression that the rule was broader than intended, it has been omitted from the final regulations.

Section 357.31 Certifying individuals.

For clarity, the warranties which accompany the use of a “Signature guaranteed” stamp have been set out.

Section 357.42 Preservation of existing rights.

This section has been deleted. The same subject-matter will be covered in §357.1, as finally adopted.

Section 357.43 Liability of Department and Federal Reserve Banks.

This section was published as §357.42 in the notice of proposed rulemaking for TRADES. The final version will be published after all the comments on the rulemaking for TRADES have been reviewed and considered.

Section 357.45 Provisions relating to Federal Reserve Banks.

The adoption of regulations for the Treasury Reserve Automated Debt Entry System (“TRADES”) is the culmination of a multi-year Treasury process of moving from issuing securities only in definitive (physical/certificated/paper) form to issuing securities exclusively in book-entry form. The TRADES regulations provide the legal framework for all commercially-maintained Treasury book-entry securities. For a more detailed explanation of the procedural and legal development of book-entry and the TRADES regulations, see the preamble to the rule proposed March 4, 1996 (61 FR 8420), as well as the earlier proposals cited therein 51 FR 8846 (March 14, 1986); 51 FR 43027 (November 28, 1986); 57 FR 12244 (April 9, 1992).

APPENDIX B TO PART 357—TRADES

COMMENTARY

INTRODUCTION

The adoption of regulations for the Treasury Reserve Automated Debt Entry System (“TRADES”) is the culmination of a multi-year Treasury process of moving from issuing securities only in definitive (physical/certificated/paper) form to issuing securities exclusively in book-entry form. The TRADES regulations provide the legal framework for all commercially-maintained Treasury book-entry securities. For a more detailed explanation of the procedural and legal development of book-entry and the TRADES regulations, see the preamble to the rule proposed March 4, 1996 (61 FR 8420), as well as the earlier proposals cited therein 51 FR 8846 (March 14, 1986); 51 FR 43027 (November 28, 1986); 57 FR 12244 (April 9, 1992).

COMPARISON OF TRADES AND LEGACY

TREASURY DIRECT

A person may hold interests in Treasury book-entry securities either in TRADES or Legacy Treasury Direct. The following summarizes the major differences between the two systems.

Persons holding Treasury book-entry securities in TRADES hold their interests in such securities in a tiered system of ownership accounts. In TRADES, Treasury, through its fiscal agencies, the Federal Reserve Banks, recognizes the identity only of Participants (persons with a direct account relationship with a Federal Reserve Bank). While Participants may be beneficial owners of interests in Treasury book-entry securities, there are many beneficial owners of such interests that are not Participants. Such beneficial owners hold their interests through one or more Securities Intermediaries such as banks, brokerage firms or securities clearing organizations.

In TRADES, the rights of non-Participant beneficial owners may be exercised only through their Securities Intermediaries. Neither Treasury nor the Federal Reserve Banks have any obligation to a non-Participant beneficial owner of an interest in a Treasury book-entry security. Two examples illustrate this principle. First, except where a pledge has been recorded directly on the books of a Federal Reserve Bank pursuant to §357.12(c)(1), Federal Reserve Banks, as Treasury’s fiscal agents, will act only on instructions of the Participant in whose Securities Intermediaries. Neither Treasury nor the Federal Reserve Banks have any obligation to a non-Participant beneficial owner of an interest in a Treasury book-entry security. A beneficial owner of the interest that is a non-Participant has no ability to direct a transfer on the books of a Federal Reserve Bank. Second, Treasury discharges its payment obligation with respect to a Treasury book-entry security when payment is credited to a Participant’s account or paid in accordance with the Participant’s instructions. Neither Treasury nor a Federal Reserve Bank has any payment obligation to a non-Participant beneficial owner of an interest in a Treasury book-entry security. A non-Participant beneficial owner receives its payment when its Securities Intermediaries credits the owner’s account.

Persons holding Treasury book-entry securities in Legacy Treasury Direct, on the other hand, hold their securities accounts on records maintained by Treasury through its fiscal agents, the Federal Reserve Banks. The primary characteristic of Legacy Treasury Direct is a direct account relationship between the beneficial owner of a Treasury book-entry security and Treasury. In Legacy Entitlement. A Participant’s Security Entitlement is different than a Security Entitlement as described in Revised Article 8, with respect to the Participant’s rights against the issuer. A non-Participant’s Security Entitlement is described in Revised Article 8.