

DEPARTMENT OF THE TREASURY

Fiscal Service

31 CFR Part 356

Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (Department of the Treasury Circular, Public Debt Series No. 1-93)

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

ACTION: Final rule.

SUMMARY: The Department of the Treasury ("Treasury" or "Department") is issuing in final form an amendment to 31 CFR Part 356 (Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds). This amendment includes changes necessary to make fungible stripped interest components for Treasury inflation-indexed securities, which the Department began issuing in January 1997. In addition, the amendment makes certain technical clarifications and conforming changes.

EFFECTIVE DATE: March 31, 1999.

ADDRESSES: This final rule is available for downloading 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, FOIA Collection, Room 5030, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C., 20220. Persons wishing to visit the library should call (202) 622-0990 for an appointment.

FOR FURTHER INFORMATION CONTACT: Kerry Lanham (Acting Director), Chuck Andreatta or Kurt Eidemiller (Government Securities Specialists), Bureau of the Public Debt, Government Securities Regulations Staff, (202) 219-3632.

SUPPLEMENTARY INFORMATION:**I. Background**

The Uniform Offering Circular (31 CFR Part 356) sets out the terms and conditions for the sale and issuance by the Department of the Treasury to the public of marketable Treasury bills, notes, and bonds. The Uniform Offering Circular, in conjunction with offering announcements, represents a comprehensive statement of those terms and conditions.¹

In January 1997, the Department began issuing a new type of marketable

security, referred to as a Treasury inflation-indexed security, whose principal value is adjusted for inflation as measured by the Bureau of Labor Statistics of the U.S. Department of Labor.² The Department believes the issuance of these new securities will reduce interest costs to the Treasury over the long term and broaden the types of debt instruments available to investors in U.S. financial markets.

Treasury inflation-indexed securities have been eligible for the STRIPS (Separate Trading of Registered Interest and Principal of Securities) program since Treasury began issuing the new securities. STRIPS is the Department's program under which eligible securities are authorized to be separated into principal and interest components (interest components are also referred to as "TINTS"). Such components are maintained in book-entry accounts, and transferred separately in the Treasury/Reserve Automated Debt Entry System ("TRADES" or the commercial book-entry system). Unlike TINTS from Treasury fixed-principal securities, TINTS stripped from an inflation-indexed security are currently not fungible (i.e., they are not interchangeable) with TINTS stripped from a different inflation-indexed security, even if the components have the same maturity (payment) date.³

In the preamble to the final rule amendments to accommodate the issuance of inflation-indexed securities, the Department stated that it would "continue to work on making interest components fungible in a manner that is operationally feasible."⁴ The Department recognizes that making stripped inflation-indexed interest components fungible is important to developing a liquid market for these components. The Department has worked with market participants to develop a methodology that will accomplish this goal.

The Department published for public comment a proposed amendment to the Uniform Offering Circular on December 8, 1997,⁵ which laid out the proposed methodology for making TINTS stripped from different Treasury inflation-indexed securities fungible. The closing date for comments was February 6, 1998. As explained in more detail below, after considering the comments provided, Treasury has decided to adopt the proposed methodology for making TINTS stripped from different inflation-indexed securities fungible. This

methodology will remain unchanged from its description in the proposed rule. However, in order to provide market participants sufficient time to make any necessary automated systems changes, the effective date of this final rule will be delayed until March 31, 1999.

II. Comments Received in Response to the Proposed Rule

The Department received one comment letter on the proposed rule, which was from The Bond Market Association ("Association").⁶ In developing the final rule, the Department took the issues raised in this comment letter into consideration, as well as input received during discussions with various active Treasury securities market participants.

The Association generally supported the Department's efforts to make TINTS of inflation-indexed securities fungible. The Association, however, cited its members' concern with "the significant modifications needed for their operational systems to accommodate the trading and maintenance of the adjusted value of stripped interest components to the penny." The Association said its members believe "that it will require approximately six to nine months to both make and test the appropriate system changes before they can begin trading the new stripped securities." Association members, the commenter said, also expressed concerns that these system changes could complicate efforts already underway to make operational system adjustments to prepare for the year 2000, the European Monetary Unit and the General Collateral Finance Repo product of the Government Securities Clearing Corporation. Similar concerns were expressed to the Department in discussions with various active Treasury market participants. The Association suggested that Treasury consider truncating the pennies from the adjusted values, so that the adjusted values would be maintained in accounts and transferred in whole dollars.

The Association supported establishing a conversion factor between securities issued under different CPI base reference periods if the Consumer Price Index's base reference period is changed. Such a factor would enable TINTS from inflation-indexed securities issued during different CPI base

⁶ See letter from Ms. Paula H. Simpkins, Vice President and Assistant General Counsel, The Bond Market Association (dated February 6, 1998). This letter is available to the public for inspection and downloading on the Internet, at the address provided earlier in this rule, and for inspection and copying at the Treasury Department Library, at the address provided earlier.

¹ The Uniform Offering Circular was published as a final rule on January 5, 1993 (58 FR 412). The circular, as amended, is codified at 31 CFR Part 356.

² 62 FR 846 (January 6, 1997).

³ See 31 CFR 356.31(f).

⁴ 62 FR 846, 848 (January 6, 1997).

⁵ 62 FR 64528 (December 8, 1997).

reference periods to be fungible. However, the Association recommended that the conversion be done on a voluntary basis so investors could decide whether the benefits outweigh the associated costs of conversion. The Association also recommended the creation of an additional conversion factor that would allow TINTS of inflation-indexed securities issued during a more-recent base period to be converted to an older base period. This additional convertibility, the commenter asserted, would further increase the marketability of the TINTS.

After taking the comments and views received into consideration, the Department is issuing a final rule that adopts the proposed rule without any significant changes. The suggestion to truncate the pennies from the calculation of adjusted values was not adopted because of the resulting payment differences to holders of inflation-indexed TINTS as compared with holders of unstripped inflation-indexed securities, particularly for smaller holders. However, in order to provide market participants with sufficient time to make any automated systems changes necessary for maintaining accounts and transferring adjusted values in pennies, Treasury has decided to adopt the recommendation of The Bond Market Association to delay the effective date. Accordingly, the effective date of this final rule will be delayed until March 31, 1999. In delaying the effective date, the Department recognizes the significant efforts of market participants in making systems changes for the year 2000 and the European Monetary Unit.

No changes are being proposed at this time to the current STRIPS program for fixed-principal securities. However, as stated in the preamble to the proposed rule, the Department will consider at a later date the desirability of making changes to the minimum and multiple requirements for fixed-principal TINTS similar to the requirements for inflation-indexed TINTS, i.e., discontinuing the \$1,000 minimum-to-hold and multiple requirement, and permitting fixed-principal TINTS to be held in amounts to the penny.

The suggestions to make conversions of adjusted values from less-recent CPI base reference periods to more-recent base reference periods voluntary, and to create an additional conversion factor to facilitate conversions of adjusted values from more-recent periods to less-recent periods, were also not adopted. The Department believes that these suggestions, had they been adopted, would have been operationally very complicated. They also would have

continued to make inflation-indexed TINTS not fungible to the extent that, in either case, there would have to be different CUSIP numbers for TINTS that have the same maturity (payment) date. The rule has been amended, therefore, so that in the event that the CPI is rebased, conversion to the most-recent base reference period will be mandatory. At such time, Treasury will publish information specifying the manner in which this conversion will be accomplished. In addition, any new TINTS created from a security that was issued during a prior base reference period will be issued with adjusted values calculated using reference CPIs under the most-recent base reference period.

The only other change in the final rule from the proposed rule is to provide for mandatory conversion to fungible TINTS of any TINTS created prior to March 31, 1999.⁷ Treasury stated in the preamble to the proposed rule that this conversion would occur because of the Department's goal, where possible, to make all TINTS from inflation-indexed securities fungible.⁸ Also as stated in the preamble to the proposed rule, Treasury will provide public notice, if necessary, informing participants of the effective conversion date, along with detailed instructions regarding the conversion to fungible STRIPS.

III. Procedural Requirements

This final rule does not meet the criteria for a "significant regulatory action" pursuant to Executive Order 12866. Although this rule was issued initially in proposed form to secure the benefit of public comment, the notice, public comment, and delayed effective date provisions 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.

There is no new collection of information contained in this final rule and, therefore, the Paperwork Reduction Act does not apply. The collections of information in 31 CFR Part 356 have been previously approved by the Office of Management and Budget under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35) under control number 1535-0112. Under this Act, an agency may not conduct or sponsor, and a

⁷ As of May 31, 1998, none of the currently outstanding inflation-indexed securities has been stripped.

⁸ 62 FR 64528, 64530 (December 8, 1997).

person is not required to respond to, a collection of information unless it displays a valid OMB control number.

List of Subjects in 31 CFR Part 356

Bonds, Federal Reserve System, Government securities, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, 31 CFR Chapter II, Subchapter B, Part 356, is amended as follows:

PART 356—SALE AND ISSUE OF MARKETABLE BOOK-ENTRY TREASURY BILLS, NOTES, AND BONDS (DEPARTMENT OF THE TREASURY CIRCULAR, PUBLIC DEBT SERIES NO. 1-93)

1. The authority citation for part 356 continues to read as follows:

Authority: 5 U.S.C. 301; 31 U.S.C. 3102, *et seq.*; 12 U.S.C. 391.

2. Section 356.2 is amended by adding in alphabetical order the definition of "Adjusted value" to read as follows:

§ 356.2 Definitions.

* * * * *

Adjusted value means, for an interest component stripped from an inflation-indexed security, an amount derived by multiplying the semiannual interest rate by the par amount and then multiplying this value by 100 divided by the Reference CPI of the original issue date (or dated date, when the dated date is different from the original issue date). (See Appendix B, Section IV to this part, for an example of how to calculate the adjusted value for interest components stripped from an inflation-indexed security.)

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3. Section 356.31 is revised to read as follows:

§ 356.31 STRIPS.

(a) *General.* A note or bond may be designated in the offering announcement as eligible for the STRIPS program. At the option of the holder, and generally at any time from its issue date until its call or maturity, any such security may be "stripped," i.e., divided into separate principal and interest components. A short or long first interest payment and all interest payments within a callable period are not eligible to be stripped from the principal component. The CUSIP numbers and payment dates for the principal and interest components are provided in the offering announcement if not previously announced.

(b) *Treasury fixed-principal securities*—(1) *Minimum par amounts*

required for STRIPS. For a fixed-principal security to be stripped into the components described above, the par amount of the security must be in an amount that, based on its interest rate, will produce a semiannual interest payment in a multiple of \$1,000. Exhibit C to this part provides the minimum par amounts required to strip a fixed-principal security at various interest rates, as well as the corresponding interest payments. Amounts greater than the minimum par amount must be in multiples of that amount. The minimum par amount required to strip a particular security will be provided in the press release announcing the auction results.

(2) *Principal components.* Principal components stripped from fixed-principal securities are maintained in accounts, and transferred, at their par amount. The principal components have a CUSIP number that is different from the CUSIP number of the fully-constituted (unstripped) security.

(3) *Interest components.* Interest components stripped from fixed-principal securities are maintained in accounts, and transferred, at their original payment value, which is derived by applying the semiannual interest rate to the par amount. When an interest component is created, the interest payment date becomes the maturity date for the component. All such components with the same maturity date have the same CUSIP number, regardless of the underlying security from which the interest payments were stripped. All interest components have CUSIP numbers that are different from the CUSIP number of any fully-constituted security and any principal component.

(c) *Treasury inflation-indexed securities*—(1) *Minimum par amounts required for STRIPS.* The minimum par amount of an inflation-indexed security that may be stripped into the components described in paragraph (a) of this section is \$1,000. Any par amount to be stripped above \$1,000 must be in a multiple of \$1,000.

(2) *Principal components.* Principal components stripped from inflation-indexed securities are maintained in accounts, and transferred, at their par amount. At maturity, the holder will receive the inflation-adjusted principal value or the par amount, whichever is greater. (See § 356.30.) The principal components have a CUSIP number that is different from the CUSIP number of the fully-constituted (unstripped) security.

(3) *Interest components.* Interest components stripped from inflation-indexed securities are maintained in accounts, and transferred, at their

adjusted value, which is derived by multiplying the semiannual interest rate by the par amount and then multiplying this value by 100 divided by the Reference CPI of the original issue date (or dated date, when the dated date is different from the original issue date). See Appendix B, Section IV to this part, for an example of how to calculate an adjusted value. The payment value of any interest component created prior to March 31, 1999, will be converted to its adjusted value. When an interest component is created, the interest payment date becomes the maturity date for the component. All such components with the same maturity date have the same CUSIP number, regardless of the underlying security from which the interest payments were stripped. The CUSIP number of any interest component created prior to March 31, 1999, will be converted to the fungible CUSIP number for the same maturity date. All interest components have CUSIP numbers that are different from the CUSIP number of any fully-constituted security and any principal component. At maturity, the payment to the holder will be derived by multiplying the adjusted value of the interest component by the Reference CPI of the maturity date, divided by 100. See Appendix B, Section IV to this part, for an example of how to calculate an actual payment amount from an adjusted value.

(4) *Rebasing of the CPI.* In the event that the CPI is rebased, the adjusted values of all outstanding inflation-indexed interest components will be converted to adjusted values based on the new base reference period. At such time, Treasury will publish information specifying the manner in which this conversion will be accomplished. Subsequent to rebasing, any TINTS created from a security that was issued during a prior base reference period will be issued with adjusted values calculated using reference CPIs under the most-recent base reference period.

(d) *Reconstituting a security.* Stripped interest and principal components may be reconstituted, i.e., restored to their fully-constituted form. A principal component and all related unmatured interest components, in the appropriate minimum or multiple amounts or adjusted values, must be submitted together for reconstitution. Interest components stripped from inflation-indexed securities are different from interest components stripped from fixed-principal securities and, accordingly, are not interchangeable for reconstitution purposes.

(e) *Applicable regulations.* Unless otherwise provided in this part, notes

and bonds stripped into their STRIPS components are governed by Subparts A, B, and D of Part 357 of this chapter.

4. Appendix B to Part 356 is amended by revising the list of section headings at the beginning of the Appendix to read as follows:

Appendix B to Part 356—Formulas and Tables

- I. Computation of Interest on Treasury Bonds and Notes.
- II. Formulas for Conversion of Fixed-Principal Security Yields to Equivalent Prices.
- III. Formulas for Conversion of Inflation-Indexed Security Yields to Equivalent Prices.
- IV. Computation of Adjusted Values and Payment Amounts for Stripped Inflation-Indexed Interest Components.
- V. Computation of Purchase Price, Discount Rate, and Investment Rate (Coupon-Equivalent Yield) for Treasury Bills.

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5. Appendix B to Part 356 is amended by redesignating Section IV as Section V and adding a new Section IV to read as follows:

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IV. Computation of Adjusted Values and Payment Amounts for Stripped Inflation-Indexed Interest Components

Note: Valuing an interest component stripped from an inflation-indexed security at its adjusted value enables this interest component to be interchangeable (fungible) with other interest components that have the same maturity date, regardless of the underlying inflation-indexed security from which the interest components were stripped. The adjusted value provides for fungibility of these various interest components when buying, selling, or transferring them, or when reconstituting an inflation-indexed security.

Definitions

C=the regular annual interest rate, payable semiannually, e.g., .03625 (the decimal equivalent of a 3-5/8% interest rate)

Par=par amount of the security to be stripped
Ref CPI_{Issue Date}=reference CPI for the original issue date (or dated date, when the dated date is different from the original issue date) of the underlying (unstripped) security

Ref CPI_{Date}=reference CPI for the maturity date of the interest component

AV=adjusted value of the interest component
PA=payment amount at maturity by Treasury

Formulas

AV=Par (C/2)/(100/Ref CPI_{Issue Date}) (rounded to 2 decimals with no intermediate rounding)

PA=AV (Ref CPI_{Date}/100) (rounded to 2 decimals with no intermediate rounding)

Example. A 10-year inflation-indexed note paying 3½% interest is issued on January 15, 1999, with the second interest payment on January 15, 2000. The Ref CPI on January 15, 1999 (Ref CPI_{Issue Date}) is 174.62783, and the Ref CPI on January 15, 2000 (Ref CPI_{Date}) is

179.86159. Calculate the adjusted value and the payment amount at maturity of the interest component.

Definitions

C=.035

Par=\$1,000,000

Ref CPI_{Issue Date}=174.62783

Ref CPI_{Date}=179.86159

Resolution

For a par amount of \$1 million, the adjusted value of each stripped interest

component is \$1,000,000 $(.035/2)(100/174.62783)$, or \$10,021.31 (no intermediate rounding).

For an interest component maturing on January 15, 2000, the payment amount is \$10,021.31 $(179.86159/100)$, or \$18,024.49 (no intermediate rounding).

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6. Exhibit C to Part 356 is amended by revising the heading to read as follows:

Exhibit C to Part 356—Minimum Par Amounts for Fixed-Principal STRIPS

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Dated: June 26, 1998.

Donald V. Hammond,

Acting Fiscal Assistant Secretary.

[FR Doc. 98-17525 Filed 6-29-98; 8:45 am]

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