

# Federal Reserve

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Thursday  
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## Part IV

# Department of the Treasury

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17 CFR Parts 400 and 420  
Government Securities Act Regulations:  
Large Position Rules; Final Rule

**DEPARTMENT OF THE TREASURY****17 CFR Parts 400 and 420**

RIN 1505-AA53

**Office of the Assistant Secretary for Financial Markets; Government Securities Act Regulations: Large Position Rules**

**AGENCY:** Office of the Assistant Secretary for Financial Markets, Treasury.

**ACTION:** Final rule.

**SUMMARY:** The Department of the Treasury ("Department" or "Treasury") is publishing final rules that establish a new Part 420 providing recordkeeping and reporting requirements pertaining to very large positions in certain Treasury securities. The regulations are promulgated pursuant to the Government Securities Act Amendments of 1993, which authorized the Secretary of the Treasury to prescribe rules requiring persons holding, maintaining or controlling large positions in to-be-issued or recently-issued Treasury securities to keep records and file reports of such large positions. The proposed rules were published to solicit public comment on December 18, 1995.

The recordkeeping rules require any person or entity that controls a position equal to or greater than \$2 billion in a specific Treasury security to maintain and preserve certain records that enable the entity to compile, aggregate and report large position information. If the Treasury requests large position information, the reporting rules require entities to file a large position report with the Federal Reserve Bank of New York if their reportable position equals or exceeds the large position threshold in a particular Treasury security as specified by the Treasury in the notice requesting the large position information. The Department's large position rules are intended to provide the Treasury and other securities regulators with information on concentrations of control that will enable them to understand better the possible reasons for apparent significant price distortions and the causes of market shortages in certain Treasury securities. Requests by the Treasury for this information are expected to be very infrequent.

**DATES:** The effective date is October 15, 1996. Further dates: See §§ 420.4(a) and 420.5.

**FOR FURTHER INFORMATION CONTACT:** Ken Papaj, Director, or Kerry Lanham, Government Securities Specialist,

Bureau of the Public Debt, Department of the Treasury, at 202-219-3632.

**SUPPLEMENTARY INFORMATION:****I. Background****A. Statutory Authority**

The Government Securities Act Amendments of 1993 (GSAA)<sup>1</sup> included a provision granting the Department the authority to write rules for large position recordkeeping and reporting in certain Treasury securities. Specifically, Section 104 of the GSAA, which amended Section 15C of the Securities Exchange Act of 1934,<sup>2</sup> authorizes the Treasury to adopt rules requiring specified persons holding, maintaining or controlling large positions in to-be-issued or recently-issued Treasury securities to maintain records and file reports regarding such positions.<sup>3</sup> The provision was in response to certain market events in 1990-91 and is designed to improve the information available to the Treasury and other regulators regarding very large positions of recently-issued Treasury securities held by market participants and to ensure that regulators have the tools necessary to understand unusual conditions in the Treasury securities market.

The GSAA gives the Department wide latitude and discretion in determining several key features and conditions that would form the underpinnings of the large position recordkeeping and reporting rules. Among the most significant of these features are: defining which persons (individually or as a group) hold, maintain or control large positions; determining the minimum size of positions to be reported; determining what constitutes "control" for the purposes of the rules; prescribing the manner in which positions and accounts are to be aggregated; identifying the types of positions to be reported; determining the securities that would be subject to the rules; and developing the form, manner and timing of reporting. Both the proposed and final rules address these points.

**B. Participation in Rulemaking Process/Solicitation of Comments**

Throughout the process of developing large position rules, the Department has sought the views of the market participants who would be directly affected by such regulations. We believed that market participant involvement in the rulemaking initiative

from its outset would facilitate greater understanding of, and support for, the final rules when implemented. Due to the potential complexity of the rules and the myriad of ways to approach them, we sought advice and initial comment on a variety of conceptual approaches to designing a large position recordkeeping and reporting system.

Accordingly, the Department issued an Advance Notice of Proposed Rulemaking (ANPR) on January 24, 1995.<sup>4</sup> The ANPR addressed several key issues, concepts and approaches to be considered in developing large position recordkeeping and reporting rules and solicited comments, suggestions and recommendations regarding how the requirements should be structured. The ANPR also contained a detailed historical background that provides a fuller understanding of the events and circumstances that resulted in the establishment of this regulatory authority, the purposes and objectives to be achieved from large position rules, and the Congressional intent behind this legislation. The comment period on the ANPR ran through May 24, 1995.<sup>5</sup> In response to the ANPR, the Department received seven comment letters which were summarized in the preamble to the proposed rules.<sup>6</sup> Rather than repeating that information here, readers are referred to the proposed rules for a discussion of the comments.

**C. The Proposed Rules**

The Department published for comment proposed large position recordkeeping and reporting rules on December 18, 1995.<sup>7</sup> The proposed rules were designed to strike a balance between achieving the purposes and objectives of the statute and minimizing costs and burdens to those entities affected by the regulations. The proposed rules required reports to be submitted only in response to a specific request by the Treasury for large position information on a particular Treasury security issue. Using this approach, reporting would be an infrequent event required primarily in response to pricing anomalies in a specific Treasury security rather than a regular, on-going process resulting from a certain pre-determined large position threshold being exceeded in a broader range of securities.

The proposed rules provided a minimum large position threshold of \$2 billion, below which the Treasury would not request large position reports.

<sup>1</sup> Pub. L. 103-202, 107 Stat. 2344 (1993).

<sup>2</sup> 15 U.S.C. 78o-5.

<sup>3</sup> Pub. L. 103-202, Sec. 104; 107 Stat. 2344, 2346-2348; 15 U.S.C. 78o-5(f).

<sup>4</sup> 60 FR 4576 (January 24, 1995).

<sup>5</sup> 60 FR 20065 (April 24, 1995).

<sup>6</sup> 60 FR 65214 (December 18, 1995).

<sup>7</sup> Ibid.

As a result, very few entities would be required to file large position reports. The proposed recordkeeping requirements would generally not apply to any reporting entity (as defined in the rules) that did not control a position that equalled or exceeded \$2 billion in a Treasury security. For those entities currently subject to recordkeeping rules of the Securities and Exchange Commission (SEC), the Treasury or the bank regulatory agencies, the proposed rules would have imposed only minor additional recordkeeping requirements and only if certain conditions were present. Finally, the proposed rules incorporated several concepts from the Treasury's auction rules (e.g., positions to be included in a reportable large position, definition of a reporting entity and method of aggregating positions) which have been in effect since March 1993 and are understood by many of the major participants in the Treasury securities market.<sup>8</sup>

In addition to considering the views expressed by the commenters to the two rulemaking proposals, Department staff has also consulted with various regulatory agencies (i.e., staff of the SEC, the Commodity Futures Trading Commission, the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York (FRBNY)) in developing the ANPR, the proposed rules and these final rules.

#### D. Scope of Large Position Rules

It is important for all market participants to recognize that large position rules create a requirement to maintain records and report information about such positions. However, these requirements apply only to entities that hold or control (i.e., exercise investment discretion over) very large positions, as determined by the Department, in specific Treasury security issues. Accordingly, there is no obligation on executing brokers and dealers to report large trades nor is there an affirmative duty to inform their customers of the large position recordkeeping and reporting requirements prescribed by this rulemaking.

The Department emphasizes that large positions are not inherently harmful and there is no presumption of manipulative or illegal intent on the part of the controlling entity merely because a position is large enough to be subject to these rules. In addition, the rules do not establish trading or position limits or require the identification of large traders or the reporting of large trades. Finally,

<sup>8</sup> Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds; 31 CFR Chapter II, Subchapter B, Part 356.

the GSAA specifically provides that the Department shall not be compelled to disclose publicly any information required to be kept or reported for large position reporting. In particular, such information is exempt from disclosure under the Freedom of Information Act (FOIA).<sup>9</sup>

#### II. Comments Received in Response to Proposed Rules

As discussed in the ANPR<sup>10</sup> and the proposed rules,<sup>11</sup> the Department made the decision, early on, to obtain the views of the market participants who would be directly affected by such regulations. In the proposed rules, which addressed and incorporated those comments received in response to the ANPR, the Department strongly encouraged market participants to submit comments, including any suggestions for reducing burdens on the industry while still achieving the objective of the rules.

In response to the proposed rules, the Department received thirteen comment letters. The letters were submitted by four trade associations, three primary government securities dealers, four bank holding companies (including two primary dealers), and one mutual fund manager.<sup>12</sup> The Department has carefully considered the comments that were received, which generally supported the approach and process adopted in the proposed rules. Each comment letter did not necessarily address all aspects of the proposed rules.

The comments have been summarized and organized into the following eight basic categories: Control and the Definition of a Reporting Entity; Reporting Threshold; Time Frame for Submitting Reports; Reportable Position Components; Report and Recordkeeping Certifications; Recordkeeping; Announcement of a Request for Reports; and General Commentary.

##### A. Control and the Definition of a Reporting Entity

Eight comment letters specifically addressed this issue. While the comments were generally in agreement with the definition of control as proposed, the concept of control premised on an entity's investment

discretion, and defining a reporting entity or a separate reporting entity under a requested "carve out" in conformity with the single bidder process in the uniform offering circular, four letters had specific recommendations.

One commenter expressed concern about the timing and aggregation requirements given the definitions of "control" and "entity" and believed that it would be difficult to aggregate all of its holdings within the proposed reporting time frame. This commenter recommended that the definition of "reporting entity" be limited to a legal entity that exercises independent investment discretion, believing that if a narrower definition were adopted then their concerns would be eliminated. The second commenter, while agreeing with the concept of control premised on investment discretion, suggested that a participant be allowed to exclude from its reportable position those securities for which the entity has investment discretion but which do not exceed a minimum threshold. This approach, which would be similar to the net long position reporting requirement in the uniform offering circular, permits bidders to exclude amounts in non-bidding controlled accounts under a certain threshold from their reporting requirement. This commenter asserted that this exclusion would significantly alleviate the burden in tracking amounts of the security subject to investment discretion.

The third letter, in specifically commenting on the application for separate reporting status, similar to the separate bidder application incorporated in the uniform offering circular, recommended that Appendix A of the rules be changed to encompass organizational components previously recognized under the uniform offering circular's definition. The fourth commenter expressed concern with the various distinctions being drawn among reporting entities, aggregating entities and separate reporting entities, stating that this will cause a myriad of problems for complex and changing financial services businesses. The commenter proposed that a narrower reporting population be defined, such as those business units which are the primary bidders for, and proprietary traders in, U.S. government securities. Within these groups, the commenter suggested excluding those securities that are not held for proprietary trading. This commenter further suggested an alternative approach which would not require the aggregation of positions, where the different business units within a firm are clearly independent,

<sup>9</sup> 5 U.S.C. 552(b)(3)(B).

<sup>10</sup> See *supra* note 4.

<sup>11</sup> See *supra* note 6.

<sup>12</sup> Public Securities Association (two letters); Investment Company Institute; British Bankers' Association; London Investment Banking Association; Goldman, Sachs & Co.; J.P. Morgan Securities, Inc.; HSBC Securities, Inc.; Bank of America; Chemical Banking Corporation; Norwest Corporation; BANC ONE Corporation; and Fidelity Management & Research Co., respectively.

while excluding all business units where securities are held as long-term investments.

#### *B. Reporting Threshold*

Seven letters directly addressed the proposed \$2 billion minimum large position threshold. Two of the seven commenters believed this threshold to be an appropriate level, with one of these commenters suggesting that the rules specifically provide that the threshold be raised from time to time based on market developments. Three other commenters stated that by including gross financing positions in the total reportable position, all primary dealers and large market participants would trigger the \$2 billion threshold and effectively be required to report their positions in all instances, due to their matched repo book and other financing activity, thereby resulting in numerous reports. Given these large matched book positions, one of the three commenters advocated that this threshold be increased to \$5 billion, while another suggested that the reportable position be based on the participant's net financing position. The third commenter, while also advocating a significant increase in the threshold, went further by recommending two other alternative approaches. In the first approach, the \$2 billion threshold would be triggered by the aggregate of the net trading position and the net fails position, excluding the gross financing position. The second alternative approach would provide participants with the option of netting the gross par amounts of securities received in financing transactions against the gross par amount of securities delivered with the same term to the same counterparty. In both approaches, the commenter stated that this would only be to determine if a firm had crossed the threshold. Once it was determined that the firm was subject to reporting, then its gross financing positions would be reported to provide for a full range of large position information.

The sixth letter, focusing on those large firms that operate in foreign markets, represented that even if the normal activity of a participant was below the threshold, if the participant was a part of a group of affiliates, it may be subject to the reporting rules. The commenter went on to state that foreign affiliates, however minimal their activity, would need to report information to the designated filing entity unless they qualified for, and received, separate reporting status. This commenter, and a seventh commenter which supported increasing the minimum threshold, suggested that the

process could be simplified by setting a minimum threshold for each aggregating entity below which the entity's position would not need to be included in the reporting entity's report.

#### *C. Time Frame for Submitting Reports*

Only one of the thirteen comment letters did not specifically address the subject of the proposed reporting time frame in which reports must be submitted once an announcement for large position information on a particular security is made by the Treasury. All twelve letters basically stated that the proposed one and one-half business day time frame was too short given the enormity of the data that would need to be gathered, reviewed and aggregated. These letters suggested that a longer period would seem more appropriate based on the effort required to compile the information, the fact that current requirements do not require holdings to be aggregated at a reporting level, and the time needed for participants with large international presences to gather the data from worldwide affiliates, especially given the different time zones. One commenter recommended extending this turnaround time to at least three business days. Others suggested four or five business days while several commenters recommended that a minimum of ten business days would be appropriate. Commenters noted that a turnaround time frame of ten business days is the same as that for large position rules in place for the equities securities market (i.e., 13d filings) and is the same as that for the SEC's proposed large trader reporting rules.

One of the commenters, while not recommending a specific time frame, suggested that even a ten business day turnaround would be insufficient. This letter proposed several alternatives to balance the need to collect information quickly and the burdens on the reporting entity. The commenter suggested that an initial or "first cut" report of summary positions be prepared which would contain less precise information. Possible alternatives would be to subsequently provide a breakdown of the various components upon request; or, accept an initial report with only trading, reverse repo, and securities borrowed positions, with additional information to follow in a longer time frame; or, permit U.S.-based entities to report first, with information regarding foreign holdings to follow upon request; or, permit filing of partial reports to address situations where an aggregating entity does not have its reportable position ready in time.

Another commenter, while recommending a time frame of not less than ten business days if the reportable position includes all securities received in pledge and in other collateralized transactions, also advocated the implementation of a phased reporting system where participants would provide certain information in less than ten business days, with the balance of the required information to be provided by the tenth business day. This commenter went on to state that many participants would be able to report their net trading positions for all aggregating entities within five to seven business days. One commenter requested that the final rule specifically provide that the reporting entities could amend a filing if the original reported information was inaccurate.

#### *D. Reportable Position Components*

Eleven of the thirteen comment letters addressed the subject of the composition of a reportable position. Certain commenters generally supported including in the total reportable position the selected components as proposed, such as net forward and net fails positions. However, the majority of commenters objected to how certain aspects of the net trading and gross financing positions were to be included or whether they should even be included in the total reportable position. For example, two commenters specifically objected to a separate reporting of the net trading position components since, as stated by one of these commenters, separate reporting serves no useful purpose because all these positions represent control. Both commenters stated that the positions should be reported as of trade date, not settlement date. These same commenters stated that those securities received under overnight repos should be excluded from the reporting and recordkeeping obligations since investment advisers do not exercise effective control over them, they are not rehypothecated, and a significant portion of these transactions are tri-party repos where the counterparties typically have the right of substitution.

The inclusion of securities received in pledge as collateral for margin loans, swap transactions, and other collateralized credit extended in the gross financing position generated the most comments from those that addressed the reportable position's components. Nine comment letters responded similarly that these pledged securities should be excluded from being reported in the gross financing position. The commenters stressed there are minimal policy benefits to be

derived by including them and that this information would be of marginal utility. The inclusion of these securities is based on the premise that the pledgee maintains control. However, the commenters stated that firms do not control those securities received in pledge since the pledgor often has the right to substitute them in accordance with the market practice of pledging general collateral rather than specific securities identified by particular CUSIPs (i.e., a unique identifying number assigned to each separate security issue and separate STRIPS component). The letters also stressed that most firms or market participants do not have a systematic method for aggregating these positions firm-wide and do not possess the operational capacity or systems to track those securities pledged by CUSIP. It was argued that it would be prohibitively expensive to design and implement systems and procedures to track these pledged securities by CUSIP. Two letters, in particular, stressed that if these securities received in pledge and securities in other collateralized transactions were to be included in the final rules then market participants should continue to be provided the option to exclude the securities collateral over which the pledgor retains the right to substitute or which is subject to third party custodial relationships. Further, the amount of such exclusions should not be required to be reported separately in a memorandum entry in the report. One letter stated that the rules should allow for the netting of repos and reverse repos when the counterparty is a primary government securities dealer.

Two commenters requested further clarification on different position components. One of the letters stated that while fails should be included in a reportable position, the rules should clarify that fails are not included in the calculation for the cash/immediate net settled position. The second letter requested clarification on the treatment of forward start repos and reverse repos, believing that they should be included in the gross financing position. This commenter also requested clarification that fails to receive or fails to deliver would not be included in the cash/immediate net settled position since this would avoid double counting in the reports. This letter suggested that fails be treated similarly to forwards and that fails should be able to be netted with other components as either a positive or negative number. This commenter suggested amending the proposed rules to permit net fails to be less than zero.

#### *E. Report and Recordkeeping Certifications*

Six letters specifically commented on the proposed report and recordkeeping certifications and essentially objected to, or would find problematic, the requirement that only certain senior executives would be permitted to sign the report and certify the adequacy of the reporting entity's recordkeeping system. It was recommended that the rules be broadened to provide that others, such as the chief legal or compliance officers, or individuals authorized by the designated filing entity, be able to sign the reports and recordkeeping certifications. This approach would be consistent with the requirement under Section 13 of the Securities Exchange Act of 1934.

Three letters, in particular, expressed concern about the obligations and responsibilities with respect to the certifications that must be given by the designated filing entity on behalf of the reporting entity and its aggregating entities. It was recommended that the certifications in the final rules specifically permit the designated filing entity to rely on certifications or other reasonable bases of evidence of the accuracy of the information as provided by the aggregating entities.

#### *F. Recordkeeping*

Five letters directly addressed the proposed recordkeeping requirements. Two of these letters objected to applying the rules to those entities that had a large position at any time during the two-year period ending ninety days after publication of the final rules since the reviews of records to determine whether a large position was held would be an extensive, time consuming, and very costly process and would amount to a retroactive application of a new requirement. It was recommended that if this requirement were retained, entities be given the option of certifying or notifying the FRBNY that the holding of a large position is based on the entity's general knowledge of past investment and trading activities, without actually reviewing their records to document this fact. Another two letters specifically commented on the imposition of a significant recordkeeping burden on unregulated aggregating entities. Both letters stressed the view that this additional compliance burden, with these unregulated firms having to design and implement recordkeeping systems, may cause certain entities to either re-evaluate or curtail their participation in the Treasury market. One letter suggested

that these unregulated entities be excluded from these requirements.

#### *G. Announcement of a Request for Reports*

Five letters addressed the issue that the Treasury would annually test the reporting of large positions by requesting reports. Four letters recommended that when this request for large position information is made, the Treasury should notify market participants that it is a test. This is because some participants will assume that all such requests are real and their reactions may create price anomalies where none existed. One letter, in particular, stressed that advising market participants that the request is a test would not cause firms to be less diligent in complying with the rules and that firms would in every case have a legal obligation to submit the required information in a timely and accurate manner.

One letter recommended that the start of the response period, in which the reports would be required to be submitted, should be triggered by publication of the announcement in the Federal Register, which would provide more certainty than a press release, that the notice was received. Another letter, from a trade association, suggested that while they support the issuance of a press release and publication in the Federal Register, they would also like to be immediately notified when the release is provided to third party wire services so that they can redistribute the notice to their members.

#### *H. General Commentary*

Nine of the thirteen comment letters expressed general support for the proposed rules and the desired effect to prevent and detect market manipulation. Specifically, the letters supported the approach taken in providing for a \$2 billion reporting threshold, an on-demand reporting system where reports are required to be submitted in response to infrequent requests, and relying on records that are already required to be maintained. Three of the nine letters stated that certain features of the proposed rules would be overly burdensome and pose compliance problems.

One commenter agreed that the proposed rules strike the appropriate balance between achieving the purposes of the statute and minimizing the costs to the affected entities. Another commenter, while generally supportive, strongly objected to the Treasury reserving the right to collect information on securities issues that are older than those specified, since accommodating

historical information requests would impose significant cost burdens and business disruptions. A third commenter suggested that the FRBNY adopt an appendix to the final rules that would identify acceptable submission methods. A fourth commenter reiterated the view it expressed in response to the ANPR that the particular features of the Treasury bill market make it difficult to accumulate a concentration in these issues. A fifth commenter stated that the final rules should explicitly include a provision providing that any information required to be kept or reported will be exempt from FOIA and provided confidential treatment given its concern that the Treasury, in following up on a report, would seek the names of its advisory clients. This same commenter also stated that it does not believe that the GSAA provides the Treasury with the authority to request information on securities issues older than those defined as recently-issued and, therefore, this provision should be eliminated.

Three commenters opposed the application of the large position rules to foreign firms. One letter expressed the commenter's belief that there are complications for those firms operating in foreign markets and that the proposed rules raise concerns about the potential effect on the liquidity of the government securities market. This commenter stated that the recordkeeping requirements and open-ended obligation to file large position reports could make Treasury securities less attractive to foreign participants, many of whom structure their business so as not to bring themselves under direct U.S. regulation. This letter further urged that the issuance of the final rules be delayed until the Treasury is absolutely certain that these rules meet the stated goal. Another commenter, in addition to expressing concerns with compliance costs (particularly for major European financial conglomerates), raised the issue of the extension of extra-territorial regulation by U.S. authorities. It was this commenter's belief that the extra-territorial application of the rules would be unwarranted in principle and unworkable in practice and would "aggravate problems over the trade in services." The commenter suggested that an alternative approach would be to rely more on memoranda of understanding (MOUs) with European supervisors and less on regulations. This letter further questioned the enforcement capacity with which U.S. authorities would have to enforce the regulations outside national jurisdiction, in the context of large

foreign conglomerates. To this extent, the commenter recommended a narrower definition of the reporting population.

A third commenter stated that the extra-territorial scope of the large position rules should be modified, particularly with respect to firms domiciled in countries where foreign regulators have MOUs with U.S. authorities. This commenter stated that the Treasury should explore the possibility of obtaining large position information from the foreign regulatory authorities rather than directly from the firms. It was represented that this process would "build on \* \* \* the increasing and important trend of enhancing cooperation between regulators in the securities markets \* \* \*." This commenter further stated that large position reporting may not be needed at all for firms based in foreign jurisdictions which have rules in place to prohibit market manipulation.

### III. Section-by-Section Analysis of Changes in Response to Comments

#### A. Section 420.1—Applicability

In preparing the applicability section of the final rules, one change was made from the proposed rules. The change provides a total exemption from the large position rules to foreign central banks, foreign governments and international monetary authorities (e.g., World Bank) (collectively, foreign official organizations). The proposed rules had provided these entities a partial exemption from the rules limited to the portion of their positions maintained at the FRBNY. In response to the ANPR, the Treasury had received comments (from the FRBNY and the Investment Company Institute) on the regulatory treatment of these organizations and public comment was specifically requested on the approach taken in the proposed rules. No further comments were received.

The Department has determined to grant the foreign official organizations a total exemption after careful consideration of the costs and benefits resulting from subjecting them to large position rules. The Treasury believes that attempting to regulate these entities would create significant potential legal and practical problems. Additionally, for the infrequent occasion when foreign official organizations may control a large position in a Treasury security, this information is likely to be available from other sources. Accordingly, the Treasury perceives very little benefit to be obtained from regulating the foreign official organizations in relation to the costs that would be incurred. It is for

this reason that they are being granted a full exemption.

The exemption provided to foreign official organizations does have one limitation. To the extent that such an organization has an ownership interest in an entity that engages primarily in commercial transactions (e.g., a nationalized commercial bank), the exemption does not extend to that entity. This limitation is designed to provide equivalent treatment to all commercial market participants regardless of their ownership structure.

Three commenters objected to the applicability of the rules to foreign firms (i.e., foreign private financial enterprises). Two argued that the extra-territorial application of the rules by U.S. regulators would be either unwarranted in principle and unworkable in practice or unnecessary for many foreign firms since they are already subject to the rules of their domestic supervisor prohibiting market manipulation. The commenters recommended that, in lieu of an extra-territorial application of the rules, Treasury: (1) Rely more on MOUs with foreign regulators to obtain needed information, and (2) define a narrower reporting population for the rules (e.g., only business units that are primary bidders for, and proprietary traders in, Treasury securities).

Treasury has considered the problems related to the ability of U.S. regulators to obtain large position information from foreign investors. As a result, Treasury expects that U.S. regulators will continue to cooperate with foreign securities regulators through MOUs and other means when and if such actions become necessary. It is impractical to exempt foreign investors from the large position rules since the potential exists for these entities to amass large positions in Treasury securities, and further, the granting of such an exemption could cause U.S.-based entities to move their securities holdings overseas to foreign firms. Accordingly, the Treasury has decided to retain the requirement that foreign private financial enterprises be subject to the large position rules.

The commenters also asserted that compliance costs for foreign firms—especially European financial conglomerates—would be considerable. The Treasury believes that the changes made to the proposed rules, as explained in the remainder of this section of the preamble, together with the fact that the on-demand reporting system does not require aggregation of positions on a daily basis, will facilitate the ability of affected firms, including foreign firms, to comply with the rules

without incurring substantial compliance costs.

#### B. Section 420.2—Definitions

Comments were received on paragraph 420.1(d) of the proposed rules, which reserves the Treasury's right to collect information on certain Treasury securities which do not meet the regulatory definition of "recently-issued" but reporting on them would be consistent with the purposes of the GSAA. The commenters believed that such a reservation of rights was beyond the scope of the Treasury's authority. The purpose of the provision was to provide notice to market participants that, while the definition of "recently-issued" narrowed the routine coverage of the large position rules to a small universe of securities, the authority provided to the Treasury by the GSAA is broad enough to be applied to a larger group of securities and that, in certain rare circumstances, the Treasury may choose to invoke this broader authority. Treasury continues to hold this view.

After consideration of these comments, and to make clear that "recently-issued" is not limited by statute to the two or three most recent issues of a security, the Department has removed paragraph 420.1(d) but revised the definition of "recently-issued" in paragraph 420.2(g) of the final rules. The revision adds a new subparagraph (5) to the definition of "recently-issued" to include Treasury security issues older than those specified in subparagraphs 420.2(g)(1) and (2) where the large position information is necessary and appropriate for monitoring the impact of concentrations of positions in Treasury securities. As discussed in the preamble to the proposed rule,<sup>13</sup> the Treasury believes that this authority to request large position information on older security issues would only be used in exceptional circumstances. One example is the April and May 1991 two-year Treasury note squeeze situations in which these securities remained of concern to the Treasury beyond the time that would otherwise have been covered by the definition of "recently-issued" in subparagraphs 420.2(g) (1) and (2). It is not the Department's intention to gather information on securities that have been outstanding for an extended period of time.

The definition of gross financing position, paragraph 420.2(c), was the subject of a number of comments principally on two different aspects of the proposed definition; the inclusion of securities collateral and the scope of the optional exclusion. As previously

described in Section II.D., many commenters were particularly concerned about the broad scope of the definition of the gross financing position. As proposed, the gross financing position included amounts of a security received from any financing transaction, including collateral for commercial loans or financial derivatives. Commenters represented that compliance with the extensive reach of this position component would be unduly burdensome and for a large, diversified reporting entity could not be calculated within the provided reporting time frame. Some of the commenters stated that in order to calculate the gross financing position they would have to develop automated systems at substantial cost. The commenters did not object to the treatment of security financing transactions such as reverse repurchase agreements and bonds borrowed.

After reviewing the comments, the Department has determined to limit the scope of the gross financing position. Specifically, all commercial lending transactions that include Treasury securities as collateral will be excluded from the gross financing position. These transactions include financings such as lines of credit, general purpose business loans and other securitized loans unrelated to activities in the financial markets. This change should greatly simplify the computation of the gross financing position for entities such as large commercial banks that extend secured commercial credit from a large number of locations and do not maintain a centralized register of the specific collateral for these transactions.

In preparing the final rules, the Treasury carefully considered the commenters' further objections to the inclusion of securities received as collateral for financial derivatives such as swap agreements. The commenters represented that since these activities are generally conducted in unregulated affiliates of regulated entities, there are few standardized systems for tracking the specific collateral obtained and that creating an obligation to determine whether a specific security is held as collateral in a very short time frame, even on an on-demand basis, would require the development of extremely expensive automated systems. The Department weighed these arguments against the potential importance of this information in ascertaining control of a particular security and decided that the benefits of including them were greater than the burdens to market participants. Factors affecting this decision were the growing popularity of collateral structures for financial derivatives, the

practical similarities between these structures and reverse repos and bonds borrowed transactions, as well as the fact that large market participants that would be affected by the large position rules already have non-integrated systems for tracking this collateral to conduct daily mark-to-market calculations and to determine the sufficiency of the collateral. Additionally, as is discussed later in the preamble, the Department has also determined to extend the reporting time frame. Accordingly, a Treasury security that has been received as collateral for a financial derivative transaction or other securities transaction (e.g., margin loan) must be included in the gross financing position.

In response to the proposed rules, commenters also noted that the optional exclusion provided in the definition of gross financing position for transactions in which securities were transferred without effective control was restricted to only some financing transactions. The Department is sympathetic to this concern and is revising the definition in paragraph 420.2(c) in the final rules to permit the optional exclusion to be available on the same terms for any collateral transaction in which securities are received. The circumstances in which control is deemed to not exist—the right to substitute securities, a third party custodial relationship or hold-in-custody agreements—remain unchanged from the proposal. Extension of the exclusion to all components of the gross financing position should further mitigate the impact of including financial derivatives collateral in the definition since many of these agreements provide for the right to substitute securities.

As a clarifying point in response to one commenter, the Department notes that forward start reverse repo transactions are to be included in the gross financing position just as forward settling trades are in the net trading position.

While the Department is not revising the definition in paragraph 420.2(d) of large position threshold, it emphasizes that the \$2 billion level is only an absolute minimum reporting level. The Treasury wishes to reiterate that, while the \$2 billion threshold triggers the recordkeeping requirements pursuant to section 420.4, no reporting burden is created until the Treasury issues a notice for information on a specific security. The Treasury envisions that the level specified in any actual request for large position information would most likely be significantly in excess of \$2 billion and would, therefore, affect

<sup>13</sup> 60 FR 65214, 65217 (December 18, 1995).

only a small number of entities. Accordingly, no change is being made to the definition.

Comments were specifically requested on the treatment of fails in the composition of a reportable position. The only negative comments received on this component suggested that the net fails position be permitted to be a negative number. The Department has decided to retain the current restriction that the net fails position should be reported as zero if it is negative. Fails to deliver that exceed fails to receive should not be used to reduce the size of a reportable position because their size is, to a great extent, controllable by the reporting entity. The Department also wishes to clarify that fails are not to be included in the net trading position and, therefore, are not double counted in computing a reportable position.

In paragraph 420.2(f), the definition of net trading position, the Department requested comment on the proposed treatment of forward settling positions. The comments that were received on this issue were supportive of the proposed treatment. Accordingly, no change has been made to the treatment of forward settling positions in the net trading position. As a reminder, all the components of a reportable position are to be computed on a trade date basis.

One commenter requested that the criteria for designation of a separate reporting entity within the definition of a reporting entity, paragraph 420.2(i) and Appendix A, be modified to parallel more closely the criteria for designation as a separate bidder in the uniform offering circular.<sup>14</sup> Specifically, the commenter asked that organizational components within an entity be permitted to establish themselves as separate reporting entities as they are permitted to be separate bidders in the uniform offering circular. To ensure consistency between the uniform offering circular and the large position rules, the Department has made a clarifying change to the term aggregating entity as defined in paragraph 420.2(a) and as used in Appendix A of the large position rules. These revisions clarify that an organizational component (e.g., a bank trust department) falls within the definition of aggregating entity and may be recognized as a separate reporting entity. Appendix A has been further revised to clarify that any entity, including an organizational component thereof, that has already received recognition from the Treasury as a separate bidder in Treasury auctions pursuant to the uniform offering circular is also recognized as a separate

reporting entity without requesting such status. However, the separate reporting entity must continue to abide by the conditions set out in the uniform offering circular that are required for recognition as a single bidder, which parallel the conditions set out in Appendix A of the large position rules for recognition as a separate reporting entity.

### C. Section 420.3—Reporting

#### 1. On-Demand Reporting System

The on-demand reporting system approach that the Treasury proposed for filing large position reports received overwhelming support from the commenters. In an on-demand reporting system, large position reports are required to be prepared and filed only in response to a notice from the Treasury requesting large position information on a specific issue of a Treasury security by those reporting entities whose positions exceeded the large position reporting threshold specified in the notice.

Nine of the twelve organizations that submitted comment letters addressed the on-demand reporting requirement and all of them supported the proposed reporting method in which large position reports would be submitted only in response to a specific, infrequent request by the Treasury. The commenters agreed with the Treasury's assessment that an on-demand reporting system would be significantly less costly and burdensome than a regular reporting system. An on-demand system would target the reporting to a specific issue of a Treasury security in response to price distortions or market anomalies, while still achieving the legislative and policy goals of strengthening the ability of the regulatory agencies to deter possible manipulation of the Treasury securities market. Thus, the on-demand approach is essential to the Treasury's overall commitment to design rules that strike an appropriate balance between achieving the purposes and objectives of the statute and minimizing costs and burdens to those entities affected by the regulations. Accordingly, the on-demand reporting requirement in paragraph 420.3(a) is being adopted without change from the proposed rules.

#### 2. Notice Requesting Large Position Reports

Another of the provisions of paragraph 420.3(a) identifies the information that will be provided in the notice that will be issued by the Treasury (i.e., press release and subsequent Federal Register notice) requesting the preparation and

submission of large position reports. Paragraph 420.3(a) is being modified to indicate that the notice will also contain, where applicable, identification of the STRIPS principal component that is related to the specific Treasury security issue for which large position information is being requested. This information is being added because the STRIPS principal component, which must be reported as part of the net trading position, has a different security description and CUSIP number from the related Treasury note or bond that would be the subject of the Treasury's request for information.

The preamble discussion to the proposed rules indicated that the Treasury notice requesting large position information would be provided to major news and financial publications and electronic financial wire services for subsequent dissemination, and published in the Federal Register.<sup>15</sup> This procedure was proposed because we believe that the press release requesting large position information would be given wide and timely distribution without undue delay in the same manner as Treasury offering announcements and auction results. However, the Public Securities Association (PSA) has expressed concern about relying on the press for notification of the large position information request and that some entities may not have access to the particular wire service carrying the notice. For these reasons, the PSA has requested that the Treasury provide it with a facsimile copy of the notice so that the PSA can immediately notify its members of the reporting obligation. To facilitate broad and timely dissemination of the notice, Treasury will provide the PSA with a copy of the press release at the time it is issued. The Treasury will similarly make a copy of the notice available to other industry or trade associations at their request.

#### 3. Information Required in Large Position Reports

##### —Net Trading Position

Paragraph 420.3(c), together with Appendix B, details the specific information that must be provided in the large position information reports. In the proposed rules, paragraph 420.3(c)(1) identified the specific component positions of the total reportable position that must be reported by the reporting entity. For the

<sup>15</sup> Since the Federal Register is the designated federal publication for providing official notice, publishing the Treasury notice in that publication is legally sufficient for "constructive notice" of the request.

<sup>14</sup> 31 CFR 356 Appendix A.



net trading position, which is one of three positions that constitute the total reportable position, the proposed rules required each of the following five components to be listed in the large position report: (1) Cash/immediate net settled positions; (2) net when-issued positions for to-be-issued and reopened issues; (3) net forward settling positions, including next day settling positions; (4) net positions in futures contracts that require delivery of the specific security; and (5) net holdings of STRIPS principal components of the security.

Two commenters objected to the requirement that each of the five components of the net trading position be reported separately since the only difference among these items is their settlement date. One of these commenters also stated that the separate reporting of the net holdings of STRIPS principal components of a security does not appear to be necessary. In response to the comments and also to reduce the amount of information that must be included in the large position report, we are revising the final rules to eliminate the separate reporting of the five components that comprise the net trading position. Reporting only the total net trading position, rather than each of the five components, is also consistent with the way the net long position is reported under the Treasury's auction rules.<sup>16</sup> Accordingly, paragraph 420.3(c)(1) has been revised to require a reporting entity to report only its net trading position, gross financing position, net fails position and the total reportable position, which is the sum of the three positions. However, Treasury or FRBNY staff may require, as a follow-up inquiry pursuant to paragraph 420.3(e), a reporting entity to provide the amount of each component that constitutes the net trading position. Reporting entities must make good faith efforts to respond to such inquiries and provide any additional information requested in a timely manner.

#### —Gross Financing Position

The gross financing position is the second of three positions constituting the total reportable position that must be included in the large position report pursuant to paragraph 420.3(c)(1) of the final rules. As discussed at length in Sections II.D. and III.B. of this preamble, the gross financing position was the subject of extensive comments regarding the inclusion of securities collateral in the position, the scope of the voluntary exclusion that permitted firms to reduce the gross financing position by the amount of securities received over

which they did not have effective control, and the requirement to report the amount of the voluntary exclusion as a memorandum entry. Section III.B. discusses how the definition of gross financing position is being modified to narrow the scope of transactions that are covered and how the voluntary exclusion is being expanded to cover all components in the gross financing position. No changes to paragraph 420.3(c)(1) are necessary to address these issues.

However, the Treasury has changed the provision in paragraph 420.3(c)(2) of the proposed rules that would have required the amount of the voluntary exclusion to be reported. Entities that would have taken advantage of the voluntary exclusion would have been required to report the amount of the exclusion in Memorandum #2. The Treasury agrees with the commenters who stated that requiring this memorandum entry would impose additional burdens, thus negating the benefits that would be derived from exercising the voluntary exclusion. As a result, the Treasury is revising paragraph 420.3(c)(2) in the final rules by deleting the requirement to report Memorandum #2—the amount excluded from the gross financing position—in the large position report.

#### —Net Fails Position

Regarding the net fails position, which is the third component of the total reportable position, two commenters requested clarification that fails should not be included in the cash/immediate net settled position component of the net trading position. The Department concurs with the views expressed by the commenters and reiterates the clarification it made in the preamble to the proposed rules that positions remaining unsettled after their scheduled settlement date are not to be included in the computation of the net trading position. As discussed earlier, the final rules adopt without change the treatment of the net fails position as proposed, i.e., net fails must be reported either as a positive number or zero.

#### —Trade Date Reporting

Paragraph 420.3(c)(3) has been revised with technical and conforming changes. Language has been added to this provision to state explicitly that all position amounts on the large position report should be reported on a trade date basis. Since two commenters stated that positions should be reported as of trade date rather than settlement date, we believe this revision to the final rules will eliminate any confusion or misunderstanding regarding this issue.

A conforming change is also being made to paragraph 420.3(c)(3) to reflect that the net trading position should be reported as one net number rather than reporting each of the five net trading position elements. See the discussion above in the section entitled Net Trading Position.

#### —Supplemental Information

As described in the proposed rules, paragraph 420.3(e) requires that a reporting entity provide, in response to a request from the FRBNY or the Treasury, information in support of its large position report. Such a request could include the detail on the five components of a net trading position. Examples of other information that may be requested include the terms of repurchase agreements involving the security, such as rate and maturity, as well as transaction volume for the reported security.

#### 4. Report Signatories and Certifications

In the proposed rules, paragraph 420.3(c)(5) provided a listing of the administrative information that must be included in the large position report, the individuals authorized to sign the report, and the required certification language attesting to the accuracy and completeness of the report and to compliance by the reporting entity with the large position rules under this part. A number of commenters recommended that the list of those individuals authorized to sign the large position reports be expanded to include other officials and further that authority to sign be permitted to be delegated to other individuals. Additionally, many commenters requested that the certification language be changed to permit the designated filing entity to rely on certifications or other reasonable bases of evidence received from the aggregating entities regarding the accuracy and completeness of the large position information provided by the aggregating entities.

In response to these comments, the Department is liberalizing and providing greater flexibility for the signatory and certification requirements. Paragraph 420.3(c)(5) as it appeared in the proposed rules is being separated into two paragraphs. New paragraph 420.3(c)(5) lists the specific administrative information that must be provided in the large position report without any substantive change from the proposal.

New paragraph 420.3(c)(6) lists the individuals authorized to sign the large position reports and provides the specific certification language that must be included in each report. This

<sup>16</sup> 31 CFR 356.13(b).

provision is being revised in the final rules by adding the chief compliance officer and chief legal officer to the list of officials authorized to sign the large position reports. In broadening the list of authorizing officials, the Department believes affected firms will have greater flexibility to determine the appropriate signatory for a particular report.

New paragraph 420.3(c)(6) also contains a provision requiring two certification statements. The first certification statement requires the person signing the large position report to certify that the information contained in the report with respect to the designated filing entity is accurate and complete. This is consistent with the certification in the proposed rules. However, the certification language regarding (i) the accuracy and completeness of the large position information related to the other aggregating entities and (ii) compliance by the reporting entity, including all aggregating entities, with the large position recordkeeping and reporting rules has been modified to permit such certifications based on lesser standards of assurance. The final rule language will enable the signatories to make the required certifications based on a standard of reasonable inquiry and best knowledge and belief. Such an approach permits the authorized official to rely on certifications, schedules or other reasonable bases of evidence that the aggregating entities provide to the designated filing entity pertaining to their holdings of large positions and compliance with the rules.

This certification approach adopted in the final rules is similar to that used by the SEC regarding reports filed under Sections 13(d) and 13(g) of the Securities Exchange Act of 1934.<sup>17</sup>

#### 5. Reporting Time Frame

Twelve of the thirteen comment letters objected to the one and one-half business day reporting time frame in the proposed rules and recommended longer time frames ranging from three to ten business days. In addition, two commenters recommended a phased reporting approach with staggered deadlines for different types of positions.

The Department is extending the time frame for filing the large position reports from one and one-half to three and one-half business days as prescribed in new paragraph 420.3(c)(7). Accordingly, reports must be received by 12:00 noon Eastern time at the FRBNY, Market Reports Division, on the fourth business

day after the issuance of the Treasury press release requesting large position information.

The Department is sympathetic to the concerns expressed by the commenters regarding the time and effort that will be needed to compile, aggregate and file the large position reports, particularly where reporting entities have a large number of aggregating entities, including foreign affiliates. To be weighed against these concerns is the need that the report be filed relatively quickly in order to accomplish its purpose. However, we believe that the significant changes that have been made in the final rules—revising the definition of gross financing position to exclude securities received as collateral for commercial loans; expanding the voluntary exclusion for the gross financing position to cover securities received on any component of the position; eliminating the requirement to report as a memorandum entry the amount of the voluntary exclusion; eliminating the need to report separately each of the five components of the net trading position; and expanding the flexibility regarding the signatory and certification requirements—will reduce the burdens associated with meeting the three and one-half business day reporting requirement.

The Department also wants to clarify a misunderstanding on the part of some commenters that the large position rules impose an on-going aggregation requirement. Neither the proposed rules nor these final rules impose a daily aggregation requirement for large position information. The Department adopted the on-demand method of reporting specifically to avoid requiring entities to redesign or develop systems that would summarize, compile and aggregate large position information on a daily basis. While all aggregating entities subject to the rules must make records of their transactions on a daily basis, only the designated filing entities are required to have a process to aggregate the large position information on behalf of the reporting entity, and then only in response to a specific request from the Treasury for large position reports. The Department is not persuaded that the rules require firms to develop system interfaces or integrated systems to compile and aggregate the required large position information.

The Department did not adopt the recommendation for a phased reporting system. We believe such a system would impose unnecessary administrative burdens and add unneeded complexity to the reporting process.

#### 6. Report Media

In response to a request for clarification, paragraph 420.3(d) has been revised to indicate that facsimile and delivered hard copy reports are the acceptable media for the large position reports. Reporting entities should contact the FRBNY staff to work out arrangements if they wish to submit the reports in a different type of media.

#### 7. Testing of Large Position Reporting System

The Department reiterates its intention to test the accuracy and reliability of the large position reporting system by requesting large position reports at least annually, regardless of market conditions for a particular security. Many commenters expressed concerns that, by the Treasury not disclosing that a request for large position information is a test, the market will assume the request is real and may react negatively, thus creating price anomalies where none existed. While the Department may announce a test as such, we intend to preserve our policy prerogative to request large position information without stating that the request is a test. The Department appreciates and understands these concerns but believes that the market should be able to discern, based on the market prices for the security issue selected for the test, that the request for large position information is only a test.

#### D. Section 420.4—Recordkeeping

The recordkeeping rules require large position holders to make and preserve records related to large position reporting requirements. The final recordkeeping rules contain minor modifications to the proposed rules, reflecting the Treasury's review of issues raised in the comment letters.

The proposed recordkeeping rules required, among other things, that each designated filing entity, in instances where its reporting entity controlled a reportable position of at least \$2 billion in any Treasury security during the prior two-year period ending 90 days after publication of the final rule, submit a letter to the FRBNY "certifying" that the designated filing entity had or would have by the effective date a recordkeeping system capable of making, verifying the accuracy of, and preserving the requisite records. (A technical change has been made in these final rules regarding this letter. Pursuant to section 420.4(a)(2) of the final large position rules, the letter must now be submitted to the Treasury's Bureau of the Public Debt, rather than to the FRBNY.)

<sup>17</sup> 17 CFR 240.13d-1; 240.13d-101; 240.13d-102, item 10; 15 U.S.C. 78m(d), 78m(g).

Four commenters objected to this requirement. Three commenters asserted that the provision, which effectively required certain firms to review positions dating back two years, was unduly time-consuming and costly since such information could not be readily collected and aggregated. The third commenter objected on the grounds that certain entities, particularly banks, are not required to maintain securities-related records that cover all Treasury securities held as collateral (e.g., collateral received to secure extensions of credit) and are not required to maintain records by CUSIP. In addition, three commenters stated that the designated filing entity should not be expected to certify the accuracy of the records of other aggregating entities within the reporting entity.

The Treasury believes that relatively few entities will be subject to the recordkeeping rules because few entities hold, have held, or expect to hold reportable positions equal to or greater than \$2 billion. Nevertheless, in order to ease the burden on, and costs to, the firms that will be subject to the rules when they become effective, the final recordkeeping rules eliminate the requirement that an affected designated filing entity make a certification in its letter to the Bureau of the Public Debt. Instead, paragraph 420.4(a)(2) of the final rules requires the designated filing entity to "state" in its letter that it has in place or will have in place a recordkeeping system to meet the requirements of the rules. Further, the final rules clarify the distinction between the designated filing entity's recordkeeping system requirements and those of the other aggregating entities in the reporting entity; each letter to the Bureau of the Public Debt now must also contain a statement that, after reasonable inquiry and to the best of its knowledge and belief, the designated filing entity "represents" that its aggregating entities also have in place or will have in place specified recordkeeping systems. In determining whether to submit a letter and to have the required recordkeeping systems in place by the effective date, a designated filing entity can now make such determinations as a result of a reasonable bases of evidence, or its general knowledge, of the magnitude of its own positions and those of its aggregating entities over the two-year time frame. These changes allow firms to avoid the time and cost of conducting a detailed review of their positions covering the prior two-year time period.

Further, as described in Section III.C. of this preamble, the final rules substantially reduce the amount of

information required to be reported pertaining to certain kinds of collateral received to secure extensions of credit (e.g., collateral for commercial loans). This change obviates the need to maintain information on some of the securities collateral about which one commenter expressed concerns.

Section III.C. also discussed the reasons for incorporating into the final reporting rules an expansion of categories of officials who are authorized to sign and certify the reports. Using the same rationale, the final recordkeeping rules in paragraph 420.4(a)(3) provide that the same expanded list of officials of the designated filing entity are authorized to sign the letter to the Bureau of the Public Debt.

The final recordkeeping rules include two additional changes from the proposed rules. In the event that a designated filing entity obtains any certifications or schedules from its aggregating entities pertaining to their holdings of a reportable position, paragraphs 420.4(b)(2) and 420.4(c)(2)(i) require the designated filing entity to maintain copies of such certifications or schedules.

The Treasury emphasizes that, although the final recordkeeping rules impose a modest amount of new requirements, particularly with regard to entities that are not currently subject to federal securities recordkeeping rules, the new requirements are not expected to necessitate significant automation or administrative expenses for the affected firms. As discussed in the preamble to the proposed rules, Treasury places a great deal of importance on minimizing the compliance burden on all affected entities, including unregulated ones. As a result, Treasury intentionally avoided imposing the vast majority of the requirements contained in SEC Rule 17a-3<sup>18</sup> on the unregulated entities. Instead, Treasury selected the most basic record (similar to the blotter requirement of SEC Rule 17a-3) that would be crucial to documenting and preparing large position reports without imposing a burden on the few unregulated firms that are likely to be subject to the recordkeeping requirements. It is our understanding that such investors already maintain records capturing most or all of the information required by the recordkeeping rules.

#### E. Section 420.5—Effective Date

Section 420.5 sets out the effective date for both the recordkeeping and reporting provisions of the large

position rules. The rules provide for a delayed effective date approximately six months after the date of this publication. This period of time is provided to give affected entities sufficient time to make the necessary preparations for compliance. Only paragraph 420.4(a) is not subject to this date but instead contains its own specific dates for compliance.

#### F. Appendix B to Part 420—Sample Large Position Report

The sample large position report in Appendix B has been shortened to conform to the changes in paragraph 420.3(c) of the final reporting rules. Refer to Section III.C. of this preamble for an explanation of the changes.

#### IV. Special Analysis

The rules do not meet the criteria for a "significant regulatory action" pursuant to Executive Order 12866.

In the preamble to the proposed rules, pursuant to the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Department certified that these amendments, if adopted, would not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis was not prepared. The proposed and final rules establish a minimum large position threshold of \$2 billion which assures market participants that the Treasury would not request large position reports below that minimum amount. The Department continues to believe that there are no small entities that will control positions of \$2 billion or greater in any Treasury security. Based on this fact and its review of the final rules being adopted herein, and since no comments were received related to this particular issue, the Department has concluded there is no reason to alter the previous certification.

The collections of information contained in the final regulations have been reviewed and 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 1535-0089. Under the Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number.

The information is being collected by the Department to enable the Treasury and other regulators to understand better the possible reasons for any apparent significant price distortions and the possible causes of market shortages in certain Treasury securities. The collection of information will help

<sup>18</sup> 17 CFR 240.17a-3.

ensure that the Treasury securities market remains liquid and efficient, and is not viewed as subject to manipulation. The final rules apply to nearly all market participants controlling large positions as defined in the rules. Per paragraph 420.3(c), it is a mandatory requirement that reporting entities with reportable positions that equal or exceed the specified threshold in a Treasury notice respond through their designated filing entities by filing a report in the required format and within the specified reporting time frame. The GSAA provides that the Department shall not be compelled to disclose publicly any information required to be kept or reported for large position reporting. Such information is exempt from disclosure under FOIA.<sup>19</sup>

*Estimated total annual reporting and recordkeeping burden:* 4,940 hours.

*Estimated annual number of recordkeepers:* 100.

*Estimated annual number of respondents:* 10.

*Estimated annual frequency of response:* On occasion.

Comments on the accuracy of the estimate for this collection of information or suggestions to reduce the burden should be sent to the Office of Information and Regulatory Affairs of the Office of Management and Budget, Attention: Desk Officer for Department of the Treasury, Washington, D.C., 20503; with copies to the Government Securities Regulations Staff, Bureau of the Public Debt, Room 515, 999 E Street, NW., Washington, D.C. 20239-0001.

#### List of Subjects

##### 17 CFR Part 400

Administrative practice and procedure, Banks, banking, Brokers, Government securities, Reporting and recordkeeping requirements.

##### 17 CFR Part 420

Foreign investments in U.S., Government securities, Investments, Reporting and recordkeeping requirements.

For the reasons set out in the preamble, 17 CFR Chapter IV, subchapter A is amended as follows:

#### **PART 400—RULES OF GENERAL APPLICATION**

1. The authority citation for part 400 is revised to read as follows:

Authority: 15 U.S.C. 78o-5.

2. In § 400.1, paragraph (e) is added as follows:

#### **§ 400.1 Scope of regulations.**

\* \* \* \* \*

(e) Section 104 of the Government Securities Act Amendments of 1993 (Pub. L. 103-202, 107 Stat. 2344) amended Section 15C of the Act (15 U.S.C. 78o-5) by adding a new subsection (f), authorizing the Secretary of the Treasury to adopt rules to require specified persons holding, maintaining or controlling a large position in to-be-issued or recently-issued Treasury securities to report such a position and make and keep records related to such a position. Part 420 of this subchapter contains the rules governing large position reporting.

3. Part 420 is added to read as follows:

#### **PART 420—LARGE POSITION REPORTING**

Sec.

420.1 Applicability.

420.2 Definitions.

420.3 Reporting.

420.4 Recordkeeping.

420.5 Effective Date.

Appendix A to Part 420—Separate Reporting Entity.

Appendix B to Part 420—Sample Large Position Report.

Authority: 15 U.S.C. 78o-5(f).

#### **§ 420.1 Applicability.**

(a) This part, including the Appendices, is applicable to all persons that participate in the government securities market, including, but not limited to: government securities brokers and dealers, depository institutions that exercise investment discretion, registered investment companies, registered investment advisers, pension funds, hedge funds and insurance companies that may control a reportable position in a recently-issued marketable Treasury bill, note or bond as those terms are defined in § 420.2.

(b) Notwithstanding paragraph (a) of this section, foreign central banks, foreign governments and international monetary authorities are exempt from this part. This exemption is not applicable to a broker, dealer, financial institution or other entity that engages primarily in commercial transactions and that may be owned in whole or in part by a foreign government.

(c) Notwithstanding paragraph (a) of this section, Federal Reserve Banks are exempt from this part for the portion of any reportable position they control for their own account.

#### **§ 420.2 Definitions.**

For the purposes of this part:

(a) "Aggregating entity" means a single entity (e.g., a parent company,

affiliate, or organizational component) that is combined with other entities, as specified in paragraph (i) of this section, to form a reporting entity. In those cases where an entity has no affiliates, the aggregating entity is the same as the reporting entity.

(b) "Control" means having the authority to exercise investment discretion over the purchase, sale, retention or financing of specific Treasury securities. Only one entity should be considered to have investment discretion over a particular position.

(c) "Gross financing position" is the sum of the gross par amounts of a security issue received from financing transactions, including reverse repurchase transactions and bonds borrowed, and as collateral for financial derivatives and other securities transactions (e.g., margin loans). In calculating the gross financing position, a reporting entity may not net its positions against repurchase transactions, securities loaned, or securities pledged as collateral for financial derivatives and other securities transactions. However, a reporting entity may elect to reduce its gross financing position by the par amount of the security received in transactions: in which the counterparty retains the right to substitute securities; that are subject to third party custodial relationships; or that are hold-in-custody agreements.

(d) "Large position threshold" means, with respect to a reportable position, the dollar par amount such position must equal or exceed in order for a reporting entity to be required to submit a large position report. The large position threshold will be announced by the Department and may vary with each notice of request to report large position information and with each specified Treasury security. However, under no circumstances will a large position threshold be less than \$2 billion.

(e) "Net fails position" is the net par amount of "fails to receive" less "fails to deliver" in the same security. The net fails position, as reported, may not be less than zero.

(f) "Net trading position" is the net sum of the following respective positions in the specific security issue:

- (1) Cash/immediate net settled positions;
- (2) Net when-issued positions;
- (3) Net forward positions, including next-day settling;
- (4) Net futures contract positions that require delivery of the specific security; and
- (5) Net holdings of STRIPS principal components of the security.

<sup>19</sup> See *supra* note 9.

(g) "Recently-issued" means:

(1) With respect to Treasury securities that are issued quarterly or more frequently, the three most recent issues of the security (e.g., in early April, the January, February, and March 2-year notes).

(2) With respect to Treasury securities that are issued less frequently than quarterly, the two most recent issues of the security.

(3) With respect to a reopened security, the entire issue of a reopened security (older and newer portions) based on the date the new portion of the reopened security is issued by the Department (or for when-issued securities, the scheduled issue date).

(4) For all Treasury securities, a security announced to be issued or auctioned but unissued (when-issued), starting from the date of the issuance announcement. The most recent issue of the security is the one most recently announced.

(5) Treasury security issues other than those specified in paragraphs (g)(1) and (2) of this section, provided that such large position information is necessary and appropriate for monitoring the impact of concentrations of positions in Treasury securities.

(h) "Reportable position" is the sum of the net trading positions, gross financing positions and net fails positions in a specified issue of Treasury securities collectively controlled by a reporting entity.

(i) "Reporting entity" means any corporation, partnership, person or other entity and its affiliates, as further provided herein. For the purposes of this definition, an affiliate is any: entity that is more than 50% owned, directly or indirectly, by the aggregating entity or by any other affiliate of the aggregating entity; person or entity that owns, directly or indirectly, more than 50% of the aggregating entity; person or entity that owns, directly or indirectly, more than 50% of any other affiliate of the aggregating entity; or entity, a majority of whose board of directors or a majority of whose general partners are directors or officers of the aggregating entity or any affiliate of the aggregating entity.

(1) Subject to the conditions prescribed in Appendix A, one or more aggregating entities, either separately or together with one or more other aggregating entities, may be recognized as a separate reporting entity.

(2) Notwithstanding this definition, any persons or entities that intentionally act together with respect to the investing in, retention of, or financing of, Treasury securities are considered, collectively, to be one reporting entity.

#### § 420.3 Reporting.

(a) A reporting entity is subject to the reporting requirements of this section only when its reportable position equals or exceeds the large position threshold specified by the Department for a specific Treasury security issue. The Department shall provide notice of such threshold by issuance of a press release and subsequent publication of the notice in the Federal Register. Such notice will identify the Treasury security issue to be reported (including, where applicable, identification of the related STRIPS principal component); the date or dates (as of close of business) for which the large position information must be reported; and the applicable large position threshold for that issue. It is the responsibility of a reporting entity to take reasonable actions to be aware of such a notice.

(b) A reporting entity shall select one entity from among its aggregating entities (i.e., the designated filing entity) as the entity designated to compile and file a report on behalf of the reporting entity. The designated filing entity shall be responsible for filing any large position reports in response to a notice issued by the Department and for maintaining the additional records prescribed in the applicable paragraph of § 420.4.

(c)(1) In response to a notice issued under paragraph (a) of this section requesting large position information, a reporting entity with a reportable position that equals or exceeds the specified large position threshold stated in the notice shall compile and report the amounts of the reporting entity's reportable position in the order specified, as follows:

- (i) net trading position;
- (ii) gross financing position;
- (iii) net fails position; and
- (iv) total reportable position.

(2) The large position report should include the following additional memorandum item: a total that includes the amounts of securities delivered through repurchase agreements, securities loaned, and as collateral for financial derivatives and other securities transactions. This total should not be reflected in the gross financing position.

(3) An illustration of a sample report is contained in Appendix B. The net trading position shall be one net number and reported as the applicable positive or negative number (or zero). The gross financing position and net fails position should each be reported as a single entry. If the amount of the net fails position is zero or less, report zero. All position amounts should be reported on

a trade date basis and at par in millions of dollars.

(4) All positions must be reported as of the close of business of the reporting date(s) specified in the notice.

(5) Each submitted large position report must include the following administrative information in addition to the reportable position: the name of the reporting entity, the address of the principal place of business, the name and address of the designated filing entity, the Treasury security that is being reported, the CUSIP number for the security being reported, the report date or dates for which information is being reported, the date the report was submitted, the name and telephone number of the person to contact regarding information reported, and the name and position of the authorized individual submitting this report.

(6) The large position report must be signed by one of the following: the chief compliance officer; chief legal officer; chief financial officer; chief operating officer; chief executive officer; or managing partner or equivalent. The designated filing entity must also include in the report, immediately preceding the signature, a statement of certification as follows:

By signing below, I certify that the information contained in this report with regard to the designated filing entity is accurate and complete. Further, after reasonable inquiry and to the best of my knowledge and belief, I certify: (i) That the information contained in this report with regard to any other aggregating entities is accurate and complete; and (ii) that the reporting entity, including all aggregating entities, is in compliance with the requirements of 17 CFR Part 420.

(7) The report must be filed before noon Eastern time on the fourth business day following issuance of the press release.

(d) A report to be filed pursuant to paragraph (c) of this section will be considered filed when received by the Federal Reserve Bank of New York, Market Reports Division. The report may be filed with the Federal Reserve Bank of New York by facsimile or delivered hard copy. The Federal Reserve Bank of New York may in its discretion also authorize additional means of reporting.

(e) A reporting entity that has filed a report pursuant to paragraph (c) of this section shall, at the request of the Department or the Federal Reserve Bank of New York, timely provide any supplemental information pertaining to such report.

(Approved by the Office of Management and Budget under control number 1535-0089)

**§ 420.4 Recordkeeping.**

(a)(1) Notwithstanding the provisions of paragraphs (b) and (c) of this section, an aggregating entity must make and maintain records pursuant to this part as of its effective date, but only if the aggregating entity has controlled a portion of its reporting entity's reportable position in any Treasury security when such reportable position of the reporting entity has equaled or exceeded the minimum large position threshold specified in § 420.2(d) (i.e., \$2 billion) during the prior two-year period ending December 11, 1996. Subsequent to the effective date, an aggregating entity that controls a portion of its reporting entity's reportable position in a recently-issued Treasury security, when such reportable position of the reporting entity equals or exceeds the minimum large position threshold, shall be responsible for making and maintaining the records prescribed in this section.

(2) In the case of a reporting entity whose reportable position in any Treasury security has equaled or exceeded the minimum large position threshold during the prior two-year period ending December 11, 1996, each such reporting entity's designated filing entity shall submit a letter to the Government Securities Regulations Staff, Bureau of the Public Debt, 999 E Street, N.W., Room 515, Washington, DC 20239, stating that the designated filing entity has in place, or will have in place by the effective date, a recordkeeping system (including policies and procedures) capable of making, verifying the accuracy of, and preserving the records required pursuant to this section. The letter shall further state that, after reasonable inquiry and to the best of its knowledge and belief, the designated filing entity represents that all other aggregating entities have in place, or will have in place by the effective date, a system (including policies and procedures) capable of making, verifying the accuracy of, and preserving the records required pursuant to this section.

(3) The letter specified in paragraph (a)(2) of this section must be signed by one of the following: the chief compliance officer; chief legal officer; chief financial officer; chief operating officer; chief executive officer; or managing partner or equivalent. The letter must be received by the Bureau of the Public Debt no later than January 21, 1997.

(b) *Records to be made and preserved by entities that are subject to the recordkeeping provisions of the Commission, the Department, or the appropriate regulatory agencies for*

*financial institutions.* As an aggregating entity, compliance by a registered broker or dealer, registered government securities broker or dealer, noticed financial institution, depository institution that exercises investment discretion, registered investment adviser, or registered investment company with the applicable recordkeeping provisions of the Commission, the Department, or the appropriate regulatory agencies for financial institutions shall constitute compliance with this section, provided that if such entity is also the designated filing entity it:

(1) Makes and keeps copies of all large position reports filed pursuant to this part;

(2) Makes and keeps supporting documents or schedules used to compute data for the large position reports filed pursuant to this part, including any certifications or schedules it receives from aggregating entities pertaining to their holdings of a reportable position;

(3) Makes and keeps a chart showing the organizational entities that are aggregated (if applicable) in determining a reportable position; and

(4) With respect to recordkeeping preservation requirements that contain more than one retention period, preserves records required by paragraphs (b)(1)-(3) of this section for the longest record retention period of applicable recordkeeping provisions.

(c) *Records to be made and kept by other entities.* (1) An aggregating entity that is not subject to the provisions of paragraph (b) of this section shall make and preserve a journal, blotter, or other record of original entry containing an itemized record of all transactions that fall within the definition of a reportable position, including information showing the account for which such transactions were effected and the following information pertaining to the identification of each instrument: the type of security, the par amount, the CUSIP number, the trade date, the maturity date, the type of transaction (e.g., a reverse repurchase agreement), and the name or other designation of the person from whom sold or purchased.

(2) If such aggregating entity is also the designated filing entity, then in addition, it shall make and preserve the following records:

(i) Copies of all large position reports filed pursuant to this part;

(ii) Supporting documents or schedules used to compute data for the large position reports filed pursuant to this part, including any certifications or schedules it receives from aggregating

entities pertaining to their holdings of a reportable position; and

(iii) A chart showing the organizational entities that are aggregated (if applicable) in determining a reportable position.

(3) With respect to the records required by paragraphs (c) (1) and (2) of this section, each such aggregating entity shall preserve such records for a period of not less than six years, the first two years in an easily accessible place. If an aggregating entity maintains its records at a location other than its principal place of business, the aggregating entity must maintain an index that states the location of the records, and such index must be easily accessible at all times.

(Approved by the Office of Management and Budget under control number 1535-0089)

**§ 420.5 Effective Date.**

The provisions of this part, except for § 420.4(a), shall be first effective on March 31, 1997.

**Appendix A to Part 420—Separate Reporting Entity**

Subject to the following conditions, one or more aggregating entity(ies) (e.g., parent, subsidiary, or organizational component) in a reporting entity, either separately or together with one or more other aggregating entity(ies), may be recognized as a separate reporting entity. All of the following conditions must be met for such entity(ies) to qualify for recognition as a separate reporting entity:

(1) Such entity(ies) must be prohibited by law or regulation from exchanging, or must have established written internal procedures (i.e., Chinese walls) designed to prevent the exchange of information related to transactions in Treasury securities with any other aggregating entity;

(2) Such entity(ies) must not be created for the purpose of circumventing these large position reporting rules;

(3) Decisions related to the purchase, sale or retention of Treasury securities must be made by employees of such entity(ies). Employees of such entity(ies) who make decisions to purchase or dispose of Treasury securities must not perform the same function for other aggregating entities; and

(4) The records of such entity(ies) related to the ownership, financing, purchase and sale of Treasury securities must be maintained by such entity(ies). Those records must be identifiable—separate and apart from similar records for other aggregating entities.

To obtain recognition as a separate reporting entity, each aggregating entity or group of aggregating entities must request such recognition from the Department pursuant to the procedures outlined in paragraph 400.2(c) of this title. Such request must provide a description of the entity or group and its position within the reporting entity, and provide the following certification:

“[Name of the entity(ies)] hereby certifies that to the best of its knowledge and belief it meets the conditions for a separate reporting entity as described in Appendix A to 17 CFR Part 420. The above named entity also certifies that it has established written policies or

procedures, including ongoing compliance monitoring processes, that are designed to prevent the entity or group of entities from:

“(1) Exchanging any of the following information with any other aggregating entity (a) positions that it holds or plans to trade in a Treasury security; (b) investment strategies that it plans to follow regarding Treasury securities; and (c) financing strategies that it plans to follow regarding Treasury securities, or

“(2) In any way intentionally acting together with any other aggregating entity with respect to the purchase, sale, retention or financing of Treasury securities.

“The above-named entity agrees that it will promptly notify the Department in writing when any of the information provided to obtain separate reporting entity status changes or when this certification is no longer valid.”

Any entity, including any organizational component thereof, that previously has received recognition as a separate bidder in Treasury auctions from the Department pursuant to 31 CFR Part 356 is also recognized as a separate reporting entity without the need to request such status, provided such entity continues to be in compliance with the conditions set forth in Appendix A of 31 CFR Part 356.

Appendix B to Part 420—Sample Large Position Report

Formula for Determining a Reportable Position

[§ Amounts in millions at par value as of trade date]

Security Being Reported .....	_____
Date For Which Information is Being Reported .....	_____
1. Net Trading Position (Total of cash/immediate net settled positions; net when-issued positions; net forward positions, including next day settling; net futures contracts that require delivery of the specific security; and net holdings of STRIPS principal components of the security.) .....	_____
2. Gross Financing Position (Total of securities received through reverse repos (including forward settling reverse repos), bonds borrowed, financial derivative transactions and as collateral for other securities transactions which total may be reduced by the optional exclusion described in § 420.2(c).) .....	+ \$ _____
3. Net Fails Position (Fails to receive less fails to deliver. If equal to or less than zero, report 0.) .....	+ \$ _____
4. Total Reportable Position .....	= \$ _____
Memorandum: Report one total which includes the gross par amounts of securities delivered through repurchase agreements, securities loaned, and as collateral for financial derivatives and other securities transactions. Not to be included in item #2 (Gross Financing Position) as reported above.	\$ _____

Administrative Information To Be Provided in the Report

Name of Reporting Entity:  
 Address of Principal Place of Business:  
 Name and Address of the Designated Filing Entity:  
 Treasury Security Reported on:  
 CUSIP Number:  
 Date or Dates for Which Information Is Being Reported:  
 Date Report Submitted:  
 Name and Telephone Number of Person to Contact Regarding Information Reported:  
 Name and Position of Authorized Individual Submitting this Report (Chief Compliance Officer; Chief Legal Officer; Chief Financial Officer; Chief Operating Officer; Chief Executive Officer; or Managing Partner or Equivalent of the Designated Filing Entity Authorized to Sign Such Report on Behalf of the Entity):  
 Statement of Certification: “By signing below, I certify that the information contained in this report with regard to the designated filing entity is accurate and complete. Further, after reasonable inquiry and to the best of my knowledge and belief, I certify: (i) that the information contained in this report with regard to any other aggregating entities is accurate and complete; and (ii) that the reporting entity, including all aggregating entities, is in compliance with the requirements of 17 CFR Part 420.”  
 Signature of Authorized Person Named Above:

Dated: August 14, 1996.  
 Darcy Bradbury,  
*Assistant Secretary (Financial Markets).*  
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