

DEPARTMENT OF THE TREASURY**Fiscal Service****31 CFR Part 344**

[Department of the Treasury Circular, Public Debt Series No. 3-72]

U.S. Treasury Securities—State and Local Government Series

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

ACTION: Notice of proposed rulemaking with request for comments.

SUMMARY: The Department of the Treasury (Treasury) is issuing this Notice of Proposed Rulemaking (NPRM) to revise the regulations governing State and Local Government Series (SLGS) securities. SLGS securities are non-marketable Treasury securities that are only available for purchase by issuers of tax-exempt securities. The NPRM deals with certain practices of issuers that in effect use the SLGS program as a cost-free option and which Treasury considers to be contrary to the purpose of the SLGS program. These practices also create volatility in Treasury's cash balances, make cash balance forecasting more difficult, and increase Treasury's borrowing costs. We are proposing changes to eliminate these practices. We are also proposing other changes that are designed to improve the administration of the SLGS program.

DATES: To be considered, comments must be received on or before November 1, 2004.

ADDRESSES: You may submit comments, identified by Docket Number BPD-02-04, by any of the following methods:

- *Federal eRulemaking Portal:* <<http://www.regulations.gov>>. Follow the instructions for submitting comments.
- *Agency Web Site:* <<http://www.publicdebt.treas.gov>>. Follow the instructions for submitting comments via e-mail to <opda-sib@bpd.treas.gov>.
- *E-mail:* <opda-sib@bpd.treas.gov>. Include Docket Number BPD-02-04 in the subject line of the message.
- *Fax:* 304-480-5277.
- *Mail:* Keith Rake, Deputy Assistant Commissioner, Bureau of the Public Debt, Department of the Treasury, P.O. Box 396, Parkersburg, WV 26101-0396, or Edward Gronseth, Deputy Chief Counsel, Elizabeth Spears, Senior Attorney, or Brian Metz, Attorney-Adviser, Office of the Chief Counsel, Bureau of the Public Debt, Department of the Treasury, P.O. Box 1328, Parkersburg, WV 26106-1328.
- *Hand Delivery/Courier:* Keith Rake, Deputy Assistant Commissioner, Office

of the Assistant Commissioner, Bureau of the Public Debt, Department of the Treasury, 200 3rd St., Parkersburg, WV 26101, or Edward Gronseth, Deputy Chief Counsel, Elizabeth Spears, Senior Attorney, or Brian Metz, Attorney-Adviser, Office of the Chief Counsel, Bureau of the Public Debt, Department of the Treasury, 200 3rd St., Parkersburg, WV 26101.

Instructions: All submissions received must be addressed to the Bureau of the Public Debt and include the Docket Number for this NPRM, BPD-02-04. All comments received will be posted without change to <<http://www.publicdebt.treas.gov>>. The posting will include any personal information that you provide in the submission.

FOR FURTHER INFORMATION CONTACT:

Keith Rake, Deputy Assistant Commissioner, Office of the Assistant Commissioner, Bureau of the Public Debt, 200 3rd St., P.O. Box 396, Parkersburg, WV 26106-0396, (304) 480-5101, or by e-mail at <opda-sib@bpd.treas.gov> or Edward Gronseth, Deputy Chief Counsel, Elizabeth Spears, Senior Attorney, or Brian Metz, Attorney-Adviser, Office of the Chief Counsel, Bureau of the Public Debt, Department of the Treasury, P.O. Box 1328, Parkersburg, WV 26106-1328.

SUPPLEMENTARY INFORMATION:**I. Practices and Regulatory Proposals**

Treasury offers SLGS securities to issuers of tax-exempt securities. The purpose of the SLGS program is to assist state and local government issuers in complying with yield restriction and rebate requirements applicable to tax-exempt securities under the Internal Revenue Code.

In 1996, Treasury revised the regulations governing SLGS securities to make the program a more flexible and competitive investment vehicle for issuers in a manner that was intended to be cost effective. 61 FR 55690 (October 28, 1996). The regulations were revised to eliminate a number of requirements, including a requirement that issuers provide certain certifications as a condition to purchasing SLGS securities. In addition, the regulations were changed to permit an issuer to subscribe for SLGS securities and subsequently cancel the subscription, without a monetary penalty, under certain circumstances.

In 1997, Treasury amended the regulations to clarify that certain transactions in which issuers use SLGS securities to provide a cost-free interest rate hedge or option are prohibited. 62 FR 46444 (September 3, 1997). A new provision was added (current

§ 344.2(f)(1), (f)(2)) to the effect that it is impermissible to subscribe for SLGS securities for deposit in a defeasance escrow or fund if (1) the amount of SLGS securities subscribed for, plus the securities already in the escrow or fund, plus the amount the issuer has acquired or has a right to acquire for deposit in the escrow or fund, exceeds the total amount of securities needed to fund such escrow or fund and (2) the securities in the escrow or fund are subject to an agreement conditioned on changes in the interest rate on open market Treasury securities. Examples of acceptable and unacceptable practices were also provided (current § 344.2(f)(2)).

Treasury noted that the prices established for SLGS securities do not include the cost of an option. Treasury considered whether it would be consistent with the purposes of the SLGS securities program to allow SLGS securities to serve as options if Treasury were appropriately compensated and second, if the answer to the first question is affirmative, whether there is a practical way for the Department to charge for the use of SLGS securities as options. Neither question was answered at that time. Treasury stated that unless it determines that it would be both advisable and practical to allow SLGS securities to serve as options if Treasury is appropriately compensated, the use of SLGS securities for such purpose would continue to be an inappropriate use of the SLGS program. We have determined at this time that it would not be practical to price options.

Treasury has recently become aware of several other practices involving SLGS securities that are also inappropriate uses of the securities and contrary to the purpose of the program. Many of these practices are variations on the use of SLGS securities as some form of a cost-free option. These practices also result in volatility in Treasury's cash balances and make cash-balance forecasting more difficult. Cash balance volatility creates uncertainty in the amount of marketable Treasury securities Treasury needs to issue and results in increased borrowing costs. These practices also result in higher administrative costs for Treasury.

A. Redemptions Before Maturity

Certain participants in the municipal bond market have noted that the early determination of SLGS rates and movements in market prices create arbitrage opportunities. Many arbitrage transactions have been undertaken as escrow restructurings (including redemptions of SLGS securities to reinvest in SLGS securities or

marketable securities at a higher yield), to eliminate “negative arbitrage.” Negative arbitrage occurs when bond proceeds are invested at a yield that is less than the yield on the issuer’s bond, often as a result of market conditions where the maximum SLGS rates available are lower than what would be permissible under the arbitrage requirements. Under the current regulations, such restructuring transactions to reinvest at a higher yield generally are not prohibited.

Treasury has concluded, however, that the practice of requesting redemption of SLGS securities before maturity to take advantage of relatively infrequent SLGS pricing is an inappropriate use of SLGS securities. Even if undertaken to eliminate negative arbitrage, Treasury considers this practice to be a cost-free option and inconsistent with the purpose of the program. There is a direct cost to Treasury in that Treasury is not being compensated for the value of the option. This practice also results in volatility in Treasury’s cash balances and increases the difficulty of cash balance forecasting and thereby increases Treasury’s borrowing costs. All redemptions before maturity also create administrative costs.

In this NPRM, we propose several changes to eliminate this practice and similar practices.

First, for SLGS securities subscribed for on or after the date of publication of the final rule, it would be impermissible to invest any amount received from the redemption before maturity of a SLGS Time Deposit security at a yield that exceeds the yield used to determine the amount of redemption proceeds for such Time Deposit security. It would also be impermissible to purchase a SLGS security with any amount received from the sale or redemption (at the option of the holder) before maturity of any marketable security, if the yield on such SLGS security being purchased exceeds the yield at which such marketable security is sold or redeemed. These impermissible practices would be added to § 344.2(f)(1), with conforming changes to the examples in proposed § 344.2(f)(2)(ii) and (iii).

In addition, as set forth in proposed § 344.2(e)(3)(i), upon starting a subscription for a SLGS security, a subscriber would be required to certify that: (A) If the issuer is purchasing a SLGS security with the proceeds of the sale or redemption (at the option of the holder) before maturity of any marketable security, the yield on such SLGS security does not exceed the yield at which such marketable security was sold or redeemed; and (B) if the issuer

is purchasing a SLGS security with proceeds of the redemption before maturity of a Time Deposit security, the yield on the SLGS security being purchased does not exceed the yield used to determine the amount of redemption proceeds for such redeemed Time Deposit security.

Upon submission of a request for redemption before maturity of a Time Deposit security, the issuer would be required to certify that no amount received from the redemption will be invested at a yield that exceeds the yield used to determine the amount of redemption proceeds for such Time Deposit security. § 344.2(e)(3)(ii).

These certifications would be made electronically through SLGSafe (Treasury’s web-based service through which subscribers submit SLGS securities transactions). SLGSafe is administered by the Bureau of the Public Debt (BPD).

We are proposing a definition of “yield” in § 344.1 that would apply to the certifications. The definition would require that, in comparing the yield of a SLGS security to the yield of a marketable debt instrument, the yield of the marketable debt instrument would be computed using the same compounding intervals and financial conventions used to compute interest on the SLGS security. The certifications do not contemplate any adjustment for credit quality in determining yield in the event that the marketable securities are other than U.S. Treasury securities (e.g., securities of a government-sponsored enterprise). We concluded that it would not be practical to determine the portion of yield differentials that is attributable to differences in credit.

The certifications refer to sales or redemptions of securities “before maturity;” they do not cover redemptions of securities at maturity. The proposal in this NPRM limits the yield on reinvestment of proceeds of SLGS redeemed before maturity. The proposal does not prohibit restructurings of an existing escrow to enhance the efficiency of the escrow, so long as the transaction complies with the yield limitations in the NPRM.

The yield certification for subscriptions would apply to subscriptions submitted on or after the effective date of the final rule. The yield certification for redemptions before maturity would apply to requests for redemption of Time Deposit securities subscribed for on or after the effective date of the final rule. We anticipate that the effective date of the final rule will be the date of publication of the final rule. In our discretion, however, we may

determine that the effective date for some or all of the regulations will be at some later date, but the effective date will be no earlier than the date of publication of the final rule.

Second, we propose to reduce the number of hours during which SLGSafe subscriptions, requests for early redemption of Time Deposit securities, and requests for redemptions of Demand Deposit securities will be received to business days from 10 a.m. to 6 p.m., Eastern time. The 6 p.m. closing-time generally corresponds to when trading in the over-the-counter market in marketable securities declines in New York. We selected an eight-hour time frame in an effort to allow sufficient time for issuers, including those on the West coast, to complete their pricing and verification procedures. § 344.3(g). Access to SLGSafe for other functions, such as viewing account balances and obtaining statements of accounts, would be provided during existing operational hours, 8 a.m. to 10 p.m., Eastern time.

All changes to a Time Deposit subscription would have to be made by 3 p.m., Eastern Time, on the issue date. We are not proposing any change to the requirement that payment on SLGS securities must be submitted by 4 p.m., Eastern time, on the issue date. § 344.2(g).

Third, we plan to implement a non-regulatory change to make the rates specified in the daily SLGS rate table more current. As provided in § 344.4(b)(1) of the current regulations, the SLGS rate table will be released to the public by 10 a.m., Eastern time, each business day. In the rare instances when we are unable to post the current day’s SLGS rates by 10 a.m., the SLGS rate table for the previous business day will apply.

Fourth, we propose to add a new provision in § 344.2(f)(1)(iv) making it impermissible to purchase a SLGS security with a maturity longer than is reasonably necessary to accomplish a governmental purpose of the issuer. A new example would also be added in proposed § 344.2(f)(2)(v).

B. Cancellations

We receive a large volume of cancellations of SLGS subscriptions submitted for the apparent purpose of re-subscribing at a higher yield. Issuers also have submitted multiple initial subscriptions for a single issue date and have later canceled some of those subscriptions, apparently because of reductions in the size of advance refunding transactions due to changes in market conditions. Some investors have subscribed for SLGS securities, later canceling the subscription or amending

the size when rates move favorably or unfavorably. In still other cases, subscriptions have been canceled because agents have subscribed for SLGS securities even though the issuer has not authorized the issuance of municipal bonds.

The ability of a SLGS investor to freely cancel a subscription is a cost-free option. The current regulations, however, permit an issuer to obtain a higher yield by canceling a SLGS subscription within the specified period and resubscribing. This provision provides a feature that is not available for marketable securities and results in hidden costs to the Federal taxpayer. The practice of canceling subscriptions also makes Treasury's cash balance forecasting more difficult and increases Treasury's borrowing costs. Treasury believes that the flexibility and efficiency associated with an issuer's ability to select maturities and interest payment dates, make SLGS securities a competitive investment vehicle, even without the cancellation option. For these reasons, we propose several changes including prohibiting cancellations.

First, cancellations of SLGS subscriptions would be prohibited unless the subscriber establishes, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option. § 344.5(c), 344.8(c). The example in § 344.2(f)(3)(iv) of the current regulations, which permits cancellation and resubscription at a higher rate, would be eliminated. The examples in current (i), (ii), (iii) and (v) also would be modified to conform with this proposal. The applicable SLGS rate table would be the table in effect on the business day in which the subscription process was begun. The penalty for an impermissible failure to take delivery of SLGS securities would remain unchanged—the municipality (or, if applicable, the conduit borrower) would be ineligible to subscribe for SLGS securities for six months. § 344.2(h).

Second, for all subscriptions submitted for Time and Demand Deposit securities on or after the date of publication of the final rule, we propose to amend the regulations to permit a change in the aggregate principal amount originally specified in the subscription of no more than ten percent. § 344.5(d)(2), § 344.8(d). Currently, subscribers for Time Deposit securities may change the aggregate principal amount specified in the initial subscription up to \$10 million or ten percent, whichever is greater. § 344.5(b)(4)(ii). There is currently no

such requirement for Demand Deposit securities; the principal amount on Demand Deposit securities may be changed without penalty under the current regulations. § 344.8(b)(3).

Third, we propose that once an issuer selects an issue date for Time and Demand Deposit securities, the subscription cannot be amended to change the issue date. § 344.5(a), § 344.8(a). Under the current regulations, investors are allowed to amend their Time Deposit subscription by extending the issue date up to seven days after the originally specified issue date. § 344.5(b)(4)(i). The current regulations do not permit the issue date on Demand Deposit securities to be amended, although typically the issue date for Demand Deposit securities is not amended because they are one-day certificates of indebtedness that are automatically rolled over each day unless redemption is requested. § 344.7.

Fourth, we propose to require that a subscriber certify, upon starting a SLGS subscription, that the issuer has authorized the issuance of the state or local bonds. § 344.2(e)(2). In addition, a description of the municipal bond issue must be provided in SLGSafe (for example, "Water and Sewer Revenue Bonds Series 2004"). In the case of a false certification, Treasury could exercise its reserved right to revoke the issuance of the SLGS securities. § 344.2(m)(4).

II. Administrative Changes

We have also taken this opportunity to review other aspects of the SLGS program. We are proposing several changes to better administer the program.

A. Pricing Longer-Dated SLGS Securities

As of October 31, 2001, Treasury discontinued issuing 30-year marketable bonds. As a result of the shrinking supply of long-dated marketable securities, Treasury is evaluating its ability to estimate the long end of the Treasury yield curve and the SLGS rates that are derived from the Treasury yield curve. Under the current regulations, Time Deposit securities are offered out to 40-year maturities (based on the longest Treasury rate). § 344.4(a).

Treasury proposes to revise the SLGS regulations to allow us to establish better pricing methods if it becomes necessary at some point in the future. The current regulations provide that "current Treasury borrowing rate" means the "the prevailing market rate, as determined by Treasury, for a Treasury security with the specified period to maturity." § 344.1. The definition of "SLGS rate" is the "current

Treasury borrowing rate" minus five basis points. § 344.1. Treasury plans to broaden the definition of "current Treasury borrowing rate." We propose that in the case where SLGS rates are needed for maturities currently not issued by the Treasury, we would have the option of establishing the SLGS rates by using suitable proxies and/or a different rate-setting methodology. We do not anticipate revising our SLGS rate methodology at this time. At any time that the Secretary determines that the methodology should be revised, we will provide notice of such change.

B. Notices of Redemption

There currently is a 10-day advance notice requirement for SLGS investors to redeem their Time Deposit securities early. § 344.6(c). We propose to increase the notification period to 14 days to improve our cash forecasting. This provision would not apply to Demand Deposit securities.

C. Mandating SLGSafe Transactions

We propose to make SLGSafe mandatory for all transactions. Under this proposal, all transactions must flow exclusively through SLGSafe, including: Certifications, confirmations, subscriptions, and redemptions. § 344.3(b).

There are tremendous operational efficiencies to be gained from mandating the use of existing web-based technology for processing SLGS transactions. We first addressed the concept of electronic subscriptions in a Proposed Rule published in the **Federal Register**, 61 FR 39228, 39230 (Jul. 26, 1996). In the interim rule that introduced SLGSafe, we stated our goal of having 100% electronic transactions by September 2002. **Federal Register**, 65 FR 55399, Sept. 13, 2000. We did not receive any comments on the interim rule.

To improve the ease of use, we improved the sign-on procedures for SLGSafe. In a Final Interim Rule, effective on August 11, 2004, we changed the method of access to SLGSafe. **Federal Register**, 69 FR 41756, Jul. 12, 2004 at § 344.3(g)(1). We did not receive any comments on the interim rule. Therefore, it is now possible to access SLGSafe with a log-on ID and password instead of using a digital certificate. The log-on ID and password access information is now contained in the SLGSafe Application for Internet Access, PD F 4144–5. § 344.3(c)(1). The application is downloadable from BPD's Web site.

Because manual subscriptions would no longer be accepted, we propose to remove the references in the regulations

to our fax number and mailing address. Submission of subscriptions by fax or mail would only be permitted to the extent it is established to the satisfaction of BPD that good cause exists to submit subscriptions by other means.

§ 344.3(f)(3). The SLGS rate table will continue to be published on BPD's Web-site. § 344.4(b)(3). If the SLGS rate table is not available by 10 a.m., the SLGS rate table for the preceding day applies. In the event of a prolonged disruption, we will provide additional information on how to conduct SLGS transactions. Notification on how to submit subscriptions manually and lock-in a SLGS rate will be given. § 344.2(l), § 344.3(f)(4).

In addition, we propose to remove references to all paper and electronic forms, except the SLGSafe Application for Internet Access, which SLGSafe users will continue to submit in paper form to BPD.

We anticipate that use of the SLGSafe service will become mandatory on or after the date of publication of the final rule. We recommend that all subscribers who are not currently SLGSafe service users submit an application for SLGSafe access to BPD as soon as possible.

D. Miscellaneous Changes

This NPRM includes miscellaneous other minor or technical changes. *See, e.g.,* proposed §§ 344.0(a), 344.0(b), 344.1, 344.2(d), 344.2(h)(2), 344.2(i), 344.2(m)(5), 344.3(d), 344.3(f), 344.3(g), 344.4(a), 344.5, 344.6(a), 344.6(c), 344.6(f), 344.7(a), 344.9(a), 344.9(c), 344.11. Some of these changes are noted below.

Current § 344.0(a) provides that issuers of tax-exempt securities may purchase SLGS securities from any amounts that: (1) Constitute gross proceeds of an issue (as defined in 26 CFR § 1.148-1(b)); or (2) assist in complying with applicable provisions of the Internal Revenue Code relating to the tax exemption. To clarify the scope of permissible sources of funds for purchasing SLGS securities, we propose to amend the regulations to provide that SLGS securities may be purchased only from amounts that constitute gross proceeds of an issue.

Under current § 344.2(h)(2), late payment assessments, which include a \$100 administrative fee, are due on demand. We propose to revise this provision to state that SLGS securities will not be issued until such time as we receive payment of the assessments. In addition, we have added language to allow us to publish a notice in the **Federal Register** if we determine the administrative fee should be changed.

We do not anticipate raising the amount of the administrative fee at this time.

Current § 344.2(m) sets forth some of the rights Treasury reserves in administering the SLGS program. We propose to add a new § 344.2(m)(5) which would clarify that Treasury may review any transaction to ensure compliance with this part, including requiring an issuer to provide us with additional information relating to SLGS transactions, and determine an appropriate remedy under the circumstances.

We are proposing a number of technical changes to make the regulations consistent with current SLGSafe procedures and terminology, and to conform to other changes in this NPRM. In § 344.5, we have eliminated terminology referring to "initial" and "final" subscriptions because SLGSafe does not distinguish between "initial" and "final" subscriptions. Instead of submitting an "initial" subscription, the issuer would start the subscription process by entering certain information in required data fields in SLGSafe. A subscriber would complete the subscription by furnishing additional information in the designated required data fields in SLGSafe.

In proposed § 344.11, we have clarified that the early redemption provisions for the existing regulations apply to special zero interest securities. Issuance of special zero interest securities was discontinued on October 28, 1996. The proposals in this NPRM do not apply to these outstanding SLGS securities.

III. Procedural Requirements

A. Executive Order 12866

This notice of proposed rulemaking is not a significant regulatory action as defined in E.O. 12866, dated September 30, 1993, and is not a major rule under 5 U.S.C. 804. Therefore, a regulatory assessment of anticipated benefits, costs, and regulatory alternatives is not required.

B. Regulatory Flexibility Act

Although this notice of proposed rulemaking is being issued in proposed form to secure the benefit of public comment, it relates to matters of public contract and procedures for United States securities. Therefore, the notice and public procedure requirements of the Administrative Procedure Act, 5 U.S.C. 553(a)(2), are inapplicable. Since a notice of proposed rulemaking is not required, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, do not apply.

C. Paperwork Reduction Act

The collection of information contained in this proposed rule has been submitted to the Office of Management and Budget (OMB) for review under the requirements of the Paperwork Reduction Act, 44 U.S.C. 3507(d). 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 control number assigned by OMB.

Organizations and individuals desiring to submit comments concerning the collection of information in the proposed rule should direct them to the Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 (preferably by FAX to 202-395-6974, or by e-mail to jlackeyj@omb.eop.gov). A copy of the comments should also be sent to the Bureau of the Public Debt at the addresses previously specified. Comments on the collection of information should be received by November 1, 2004.

Treasury specifically invites comments on: (a) Whether the proposed collection of information is necessary for the proper performance of the mission of Treasury, and whether the information will have practical utility; (b) the accuracy of the estimate of the burden of the collections of information (see below); (c) ways to enhance the quality, utility, and clarity of the information collection; (d) ways to minimize the burden of the information collection, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

The collections of information in this proposed regulation are in sections 344.3(f)(3), 344.5(c), and 344.8(c). This information is required by the Bureau of the Public Debt (1) to determine whether there is good cause for an investor to submit subscriptions by fax or mail rather than electronically in SLGSafe and (2) to establish that a cancellation of a subscription is required for reasons unrelated to the use of the SLGS Program to create a cost-free option. This information will be used to determine whether exceptions will be granted to permit submission of subscriptions by fax or mail and cancellations of subscriptions. The likely respondents are state or local governments.

Because of the limited number of instances when a waiver may be sought, a "best estimate" has been developed based on the considered judgment of Treasury. This estimate has 1000 investors each requesting an average of one waiver per annum for a total of 1000 waiver requests annually.

The information required by Treasury in connection with a request for a waiver of the requirements under the regulations in sections 344.3(f)(3), 344.5(c), and 344.8(c) is similar to the type of information currently received by Treasury when an investor seeks relief from a provision of the current regulations. Because of the familiarity of SLGS investors with the current procedures for waivers and the infrequency of the instances in which these new waivers may be sought, the burden associated with compiling and submitting such information to Treasury is relatively modest. Accordingly, Treasury estimates that the proposed rule will impose .25 hours of burden with respect to each request with the total estimated annual burden of the proposed rule being 250 hours.

Estimated total annual reporting and/or recordkeeping burden: 250 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: .25 hours.

Estimated number of respondents and/or recordkeepers: 1000.

List of Subjects in 31 CFR Part 344

Bonds, Government Securities, Securities.

For the reasons set forth in the preamble, we propose to amend 31 CFR part 344 by revising subparts A through D to read as follows (Appendixes A and B to part 344 remain unchanged):

PART 344—U.S. TREASURY SECURITIES—STATE AND LOCAL GOVERNMENT SERIES

Subpart A—General Information

Sec.

344.0 What does this part cover?

344.1 What special terms do I need to know to understand this part?

344.2 What general provisions apply to SLGS securities?

SLGSafeSM Service

344.3 What provisions apply to the SLGSafe Service?

Subpart B—Time Deposit Securities

344.4 What are Time Deposit securities?

344.5 What other provisions apply to subscriptions for Time Deposit securities?

344.6 How do I redeem a Time Deposit security before maturity?

Subpart C—Demand Deposit Securities

344.7 What are Demand Deposit securities?

344.8 What other provisions apply to subscriptions for Demand Deposit securities?

344.9 How do I redeem a Demand Deposit security?

Subpart D—Special Zero Interest Securities

344.10 What are Special Zero Interest securities?

344.11 How do I redeem a Special Zero Interest security before maturity?

Appendix A to Part 344—Early Redemption Market Charge Formulas and Examples for Subscriptions from December 28, 1976, through October 27, 1996.

Appendix B to Part 344—Formula for Determining Redemption Value for Securities Subscribed for and Early-Redeemed on or after October 28, 1996.

Authority: 26 U.S.C. 141 note; 31 U.S.C. 3102, 3103, 3104, and 3121.

Subpart A—General Information

§ 344.0 What does this part cover?

(a) *What is the purpose of the SLGS securities offering?* The Secretary of the Treasury (the Secretary) offers for sale non-marketable State and Local Government Series (SLGS) securities to provide issuers of tax-exempt securities with investments from any amounts that constitute gross proceeds of an issue.

(b) *What types of SLGS securities are governed by this part?* This part governs the following SLGS securities:

(1) *Time Deposit securities*—may be issued as:

- (i) certificates of indebtedness;
- (ii) notes; or
- (iii) bonds.

(2) *Demand Deposit securities*—may be issued as certificates of indebtedness.

(3) *Special Zero Interest securities.* Special Zero Interest securities, which were discontinued on October 28, 1996, were issued as:

- (i) certificates of indebtedness; or
- (ii) notes.

(c) *In what denominations are SLGS securities issued?* SLGS securities are issued in the following denominations:

(1) *Time Deposit securities*—a minimum amount of \$1,000, or in any larger whole dollar amount; and

(2) *Demand Deposit securities*—a minimum amount of \$1,000, or in any larger amount, in any increment.

(d) *How long is the offering in effect?* The offering continues until terminated by the Secretary.

§ 344.1 What special terms do I need to know to understand this part?

As appropriate, the definitions of terms used in this part are those found in the relevant portions of the Internal Revenue Code and the Income tax regulations.

Bond equivalent yield means the annualized yield computed by doubling the semiannual yield.

BPD's website refers to <<http://www.slg.gov>>.

Business day(s) means Federal business day(s).

Current Treasury borrowing rate means the prevailing market rate, as determined by Treasury, for a Treasury security with the specified period to maturity. In the case where SLGS rates are needed for maturities currently not issued by Treasury, at our discretion, suitable proxies for Treasury securities and/or a rate setting methodology, as determined by the Secretary, may be used to derive a current Treasury borrowing rate. At any time that the Secretary establishes such proxies or a rate-setting method or determines that the methodology should be revised, we will make an announcement.

Day(s) means calendar day(s).

Issuer refers to the Government body that issues state or local government bonds described in section 103 of the Internal Revenue Code.

SLGS rate means the current Treasury borrowing rate, less five basis points, as released daily by Treasury in a SLGS rate table.

SLGS rate table means a compilation of SLGS rates available for a given day.

"We," "us," or "the Secretary" refers to the Secretary and the Secretary's delegates at the Department of the Treasury (Treasury), Bureau of the Public Debt (BPD). The term also extends to any fiscal or financial agent acting on behalf of the United States when designated to act by the Secretary or the Secretary's delegates.

Yield of a debt instrument is the discount rate that, when used in computing the present value of all principal and interest payments remaining to be made under the debt instrument, produces an amount equal to the price of the debt instrument. In comparing the yield of a SLGS security to the yield of a marketable debt instrument, the yield of the marketable debt instrument must be computed using the same compounding intervals and financial conventions used to compute interest on the SLGS security, as specified in § 344.4(c) of this part. When comparing the yield of a SLGS note or bond to the yield of a marketable debt instrument, use the bond equivalent yield. When comparing the yield of a SLGS certificate of indebtedness to the yield of a marketable debt instrument, use the simple annual yield.

You or your refers to a SLGSafe service user or a potential SLGSafe service user.

§ 344.2 What general provisions apply to SLGS securities?

(a) *What other regulations apply to SLGS securities?* SLGS securities are subject to:

(1) The electronic transactions and funds transfers provisions for United States securities, part 370 of this subchapter, "Electronic Transactions and Funds Transfers Related to U.S. Securities"; and

(2) The Appendix to subpart E to part 306 of this subchapter, for rules regarding computation of interest.

(b) *Where are SLGS securities held?* SLGS securities are issued in book-entry form on the books of BPD.

(c) *Besides BPD, do any other entities administer SLGS securities?* The Secretary may designate selected Federal Reserve Banks and Branches, as fiscal agents of the United States, to perform services relating to SLGS securities.

(d) *Can SLGS securities be transferred?* No. SLGS securities issued as any one type, *i.e.*, Time Deposit, Demand Deposit, or Special Zero Interest, cannot be transferred for other securities of that type or any other type. Transfer of securities by sale, exchange, assignment, pledge, or otherwise is not permitted.

(e) *What certifications must the issuer or its agent provide?*

(1) *Agent Certification.* When a commercial bank or other agent submits a subscription on behalf of the issuer, it must certify that it is acting under the issuer's specific authorization. Ordinarily, evidence of such authority is not required.

(2) *Municipal Bond Issuance Certification.* Upon starting a subscription, the subscriber must certify that the issuer has authorized the issuance of the state or local bonds.

(3) *Yield Certifications.*

(i) Upon starting a subscription for a SLGS security, a subscriber must certify that:

(A) If the issuer is purchasing a SLGS security with proceeds of the sale or redemption (at the option of the holder) before maturity of any marketable security, the yield on such SLGS security does not exceed the yield at which such marketable security was sold or redeemed; and

(B) If the issuer is purchasing a SLGS security with proceeds of the redemption before maturity of a Time Deposit security, the yield on the SLGS security being purchased does not exceed the yield that was used to determine the amount of redemption proceeds for such redeemed Time Deposit security.

(ii) Upon submission of a request for redemption before maturity of a Time Deposit security subscribed for on or after the date of publication of the final rule, the issuer must certify that no amount received from the redemption will be invested at a yield that exceeds the yield that is used to determine the amount of redemption proceeds for such Time Deposit security.

(f) *What are some practices involving SLGS securities that are not permitted?*

(1) *In General.* For SLGS securities subscribed for on or after the date of publication of the final rule, it is impermissible:

(i) To use the SLGS program to create a cost-free option;

(ii) To purchase a SLGS security with any amount received from the sale or redemption (at the option of the holder) before maturity of any marketable security, if the yield on such SLGS security exceeds the yield at which such marketable security is sold or redeemed;

(iii) To invest any amount received from the redemption before maturity of a Time Deposit security at a yield that exceeds the yield that is used to determine the amount of redemption proceeds for such Time Deposit security; or

(iv) To purchase a SLGS security with a maturity longer than is reasonably necessary to accomplish a governmental purpose of the issuer.

(2) *Examples.*

(i) *Simultaneous Purchase of Marketable and SLGS Securities.* In order to fund an escrow for an advance refunding, the issuer simultaneously enters into a purchase contract for marketable securities and subscribes for SLGS securities, such that either purchase is sufficient to pay the cash flows on the outstanding bonds to be refunded, but together, the purchases are greatly in excess of the amount necessary to pay the cash flows. The issuer plans that, if interest rates decline during the period between the date of starting a SLGS subscription and the requested date of issuance of SLGS securities, the issuer will enter into an offsetting agreement to sell the marketable securities and use the bond proceeds to purchase SLGS securities to fund the escrow. If, however, interest rates do not decline in that period, the issuer plans to use the bond proceeds to purchase the marketable securities to fund the escrow and cancel the SLGS securities subscription. This practice violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used

to create a cost-free option. In addition, this practice is prohibited under paragraph (f)(1)(i).

(ii) *Sale of Marketable Securities Conditioned on Interest Rates.* The existing escrow for an advance refunding contains marketable securities which produce a negative arbitrage. In order to reduce or eliminate this negative arbitrage, the issuer subscribes for SLGS securities at a yield higher than the yield on the existing escrow, but less than the permitted yield. At the same time, the issuer agrees to sell the marketable securities in the existing escrow to a third party and use the proceeds to purchase SLGS securities if interest rates decline between the date of subscribing for SLGS securities and the requested date of issuance of SLGS securities. The marketable securities would be sold at a yield which is less than the yield on the SLGS securities purchased. The issuer and the third party further agree that if interest rates increase during this period, the issuer will cancel the SLGS securities subscription. This practice violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used to create a cost-free option. In addition, this practice is prohibited under paragraphs (f)(1)(i) and (ii).

(iii) *Sale of Marketable Securities Not Conditioned on Interest Rates.* The facts are the same as in paragraph (f)(2)(ii) of this section, except that in this case, the agreement entered into by the issuer with a third party to sell the marketable securities in order to obtain funds to purchase SLGS securities is not conditioned upon changes in interest rates on Treasury securities. This practice violates the yield gain prohibition in paragraph (f)(1)(ii) and is prohibited.

(iv) *Simultaneous Subscription for SLGS Securities and Sale of Option to Purchase Marketable Securities.* The issuer holds a portfolio of marketable securities in an account that produces negative arbitrage. In order to reduce or eliminate this negative arbitrage, the issuer subscribes for SLGS securities for purchase in sixty days. At the same time, the issuer sells an option to purchase the portfolio of marketable securities. If interest rates increase, the holder of the option will not exercise its option and the issuer will cancel the SLGS securities subscription. On the other hand, if interest rates decline, the option holder will exercise the option and the issuer will use the proceeds to purchase SLGS securities. This practice

violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used to create a cost-free option. In addition, this practice is prohibited under paragraphs (f)(1)(i).

(v) *Purchase of SLGS Securities with a Maturity Longer than Reasonably Necessary.* An issuer issues bonds to finance a construction project. The issuer reasonably expects to spend all of the proceeds of the bonds on the project within three years after the bonds are issued. Nevertheless, on the issue date of the bonds, the issuer invests all of the bond proceeds in SLGS securities with a 20-year maturity. The issuer expects to redeem all of the SLGS securities during the three-year construction period. The issuer expects that interest rates will decline substantially during that three-year period and, as a result, the issuer will realize a substantial profit from redeeming the SLGS securities before maturity. The issuer's purchase of the SLGS securities violates paragraph (f)(1)(iv) because the 20-year maturity is longer than is reasonably necessary to accomplish the issuer's governmental purpose of constructing its project.

(g) *When and how do I pay for SLGS securities?* You must submit full payment for each subscription to BPD no later than 4 p.m., Eastern time, on the issue date. Submit payments by the Fedwire funds transfer system with credit directed to the Treasury's General Account. For these transactions, BPD's ABA Routing Number is 051036476.

(h) *What happens if I need to make an untimely change or do not settle on a subscription?* An untimely change can only be made in accordance with § 344.2(n) of this part. The penalty imposed for failure to make settlement on a subscription that you submit will be to render you ineligible to subscribe for SLGS securities for six months beginning on the date the subscription is withdrawn, or the proposed issue date, whichever occurs first.

(1) *Upon whom is the penalty imposed?* If you are the issuer, the penalty is imposed on you unless you provide the Taxpayer Identification Number of the conduit borrower that is the actual party failing to make settlement of a subscription. If you provide the Taxpayer Identification Number for the conduit borrower, the six-month penalty will be imposed on the conduit borrower.

(2) *What occurs if Treasury exercises the option to waive the penalty?* If you settle after the proposed issue date and we determine that settlement is

acceptable on an exception basis, we will waive, under § 344.2(n), the six-month penalty under paragraph (h) of this section. You shall be charged a late payment assessment. The late payment assessment equals the amount of interest that would have accrued on the SLGS securities from the proposed issue date to the date of settlement plus an administrative fee of \$100 per subscription, or such other amount as we may publish in the **Federal Register**. We will not issue SLGS securities until we receive the late payment assessment, which is due on demand.

(i) *What happens at maturity?* Upon the maturity of a security, we will pay the owner the principal amount and interest due. A security scheduled for maturity on a non-business day will be redeemed on the next business day.

(j) *How will I receive payment?* We will make payment by the Automated Clearing House (ACH) method for the owner's account at a financial institution as designated by the owner. We may use substitute payment procedures, instead of ACH, if we consider it to be necessary. Any such action is final.

(k) *How do I contact BPD?* BPD's contact information is posted on BPD's Web site.

(l) *Will the offering be changed during a debt limit or disaster contingency?* We reserve the right to change or suspend the terms and conditions of the offering (including provisions relating to subscriptions for, and issuance of, SLGS securities; interest payments; early redemptions; and rollovers) at any time the Secretary determines that the issuance of obligations sufficient to conduct the orderly financing operations of the United States cannot be made without exceeding the statutory debt limit, or that a disaster situation exists. We will announce such changes by any means that the Secretary deems appropriate.

(m) *What are some of the rights that Treasury reserves in administering the SLGS program?* We may decide, in our sole discretion, to take any of the following actions. Such actions are final. Specifically, Treasury reserves the right:

(1) To reject any SLGSafe Application for Internet Access;

(2) To reject any electronic message or other message or request, including requests for subscription and redemption, that is inappropriately completed or untimely submitted;

(3) To refuse to issue any SLGS securities in any case or class of cases;

(4) To revoke the issuance of any SLGS securities and to declare the subscriber ineligible thereafter to

subscribe for securities under the offering if the Secretary deems that such action is in the public interest and any security is issued on the basis of an improper certification or other misrepresentation (other than as the result of an inadvertent error) or there is an impermissible transaction under § 344.2(f); or

(5) To review any transaction for compliance with this part, including requiring an issuer to provide additional information, and to determine an appropriate remedy under the circumstances.

(n) *Are there any situations in which Treasury may waive these regulations?* We reserve the right, at our discretion, to waive or modify any provision of these regulations in any case or class of cases. We may do so if such action is not inconsistent with law and will not subject the United States to substantial expense or liability.

(o) *Are SLGS securities callable by Treasury?* No. Treasury cannot call a SLGS security for redemption before maturity.

SLGSafeSM Service

§ 344.3 What provisions apply to the SLGSafe Service?

(a) *What is the SLGSafe Service?* SLGSafe is a secure Internet site on the World Wide Web through which subscribers submit SLGS securities transactions. SLGSafe Internet transactions constitute electronic messages under 31 CFR part 370.

(b) *Is SLGSafe use mandatory?* Yes. You must submit all transactions through SLGSafe.

(c) *What terms and conditions apply to SLGSafe?* The terms and conditions contained in the following documents, which may be downloaded from BPD's Web site and which may change from time to time, apply to SLGSafe transactions:

(1) SLGSafe Application for Internet Access and SLGSafe User Acknowledgment; and

(2) SLGSafe User's Manual.

(d) *Who can apply for SLGSafe access?* If you are an owner of SLGS securities or act as a trustee or other agent of the owner, you can apply to BPD for SLGSafe access. Other potential users of SLGSafe include, but are not limited to, underwriters, financial advisors, and bond counsel.

(e) *How do I apply for SLGSafe access?* Submit to BPD a completed SLGSafe Application for Internet Access. The form is found on BPD's Web site.

(f) *What are the conditions of SLGSafe use?* If you are designated as an

authorized user, on a SLGSafe application that we've approved, you must:

(1) Assume the sole responsibility and the entire risk of use and operation of your electronic connection;

(2) Agree that we may act on any electronic message to the same extent as if we had received a written instruction bearing the signature of your duly authorized officer;

(3) Submit electronic messages and other transaction requests exclusively through SLGSafe, except to the extent you establish to the satisfaction of BPD that good cause exists for you to submit such subscriptions and requests by other means; and

(4) Agree to submit transactions manually if we notify you that due to problems with hardware, software, data transmission, or any other reason, we are unable to send or receive electronic messages through SLGSafe.

(g) *When is the SLGSafe window open?* All SLGSafe subscriptions, requests for early redemption of Time Deposit securities, and requests for redemption of Demand Deposit securities must be received by BPD on business days no earlier than 10 a.m. and no later than 6 p.m., Eastern time. The official time is the date and time as shown on BPD's application server. Except as otherwise provided in § 344.5(d) and § 344.8(d), all other functions may be performed during the extended SLGSafe hours, from 8 a.m. until 10 p.m., Eastern time.

Subpart B—Time Deposit Securities

§ 344.4 What are Time Deposit securities?

Time Deposit securities are issued as certificates of indebtedness, notes, or bonds.

(a) *What are the maturity periods?* The issuer must fix the maturity periods for Time Deposit securities, which are issued as follows:

(1) *Certificates of indebtedness that do not bear interest.* For certificates of indebtedness that do not bear interest, the issuer can fix a maturity period of not less than fifteen days and not more than one year.

(2) *Certificates of indebtedness that bear interest.* For certificates of indebtedness that bear interest, the issuer can fix a maturity period of not less than thirty days and not more than one year.

(3) *Notes.* For notes, the issuer can fix a maturity period of not less than one year and one day, and not more than ten years.

(4) *Bonds.* For bonds, the issuer can fix a maturity period of not less than ten years and one day, and not more than forty years.

(b) *How do I select the SLGS rate?* For each security, the issuer shall designate an interest rate that does not exceed the maximum interest rate shown in the daily SLGS rate table as defined in § 344.1.

(1) *When is the SLGS rate table released?* We release the SLGS rate table to the public by 10 a.m., Eastern time, each business day. If the SLGS rate table is not available at that time on any given business day, the SLGS rate table for the preceding business day applies.

(2) *How do I lock-in a SLGS rate?* The applicable daily SLGS rate table for a SLGSafe subscription is the one in effect on the business day that you start the subscription process. This table is shown on BPD's Application server.

(3) *Where can I find the SLGS rate table?* The SLGS rate table can be obtained at BPD's Web site.

(c) *How are interest computation and payment dates determined?* Interest on a certificate of indebtedness is computed on an annual basis and is paid at maturity with the principal. Interest on a note or bond is paid semi-annually. The issuer specifies the first interest payment date, which must be at least thirty days and less than or equal to one year from the date of issue. The final interest payment date must coincide with the maturity date of the security. Interest for other than a full interest period is computed on the basis of a 365-day or 366-day year (for certificates of indebtedness) and on the basis of the exact number of days in the half-year (for notes and bonds). See the Appendix to subpart E to part 306 of this subchapter for rules regarding computation of interest.

§ 344.5 What other provisions apply to subscriptions for Time Deposit securities?

(a) *When is my subscription due?* The subscriber must fix the issue date of each security in the subscription. The issue date cannot be changed. The issue date must be a business day. The issue date cannot be more than sixty days after the date BPD receives the subscription. If the subscription is for \$10 million or less, BPD must receive a subscription at least five days before the issue date. If the subscription is for over \$10 million, BPD must receive the subscription at least seven days before the issue date.

EXAMPLE to paragraph (a): If SLGS securities totaling \$10 million or less will be issued on November 16th, BPD must receive the subscription no later than November 11th. If SLGS securities totaling more than \$10 million will be issued on November 16th, BPD must receive the subscription no later than November 9th. In all cases, if SLGS

securities will be issued on November 16th, BPD will not accept the subscription before September 17th.

(b) *How do I start the subscription process?* A subscriber starts the subscription process by entering into SLGSafe the following information:

- (1) The issue date;
- (2) The total principal amount;
- (3) The issuer's name and Taxpayer Identification Number;
- (4) The title of an official authorized to purchase SLGS securities;
- (5) A description of the municipal bond issue;
- (6) The certification required by § 344.2(e)(1), if the subscription is submitted by an agent of the issuer; and
- (7) The certification required by § 344.2(e)(2) (relating to authorization of the state or local bonds).

(c) *Under what circumstances can I cancel a subscription?* You cannot cancel a subscription unless you establish, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option.

(d) *How do I change a subscription?* You can change a subscription on or before 3 p.m., Eastern time, on the issue date. Changes to a subscription are acceptable with the following exceptions:

- (1) You cannot change the issue date;
- (2) You cannot change the aggregate principal amount originally specified in the subscription by more than ten percent; and
- (3) You cannot change an interest rate to exceed the maximum interest rate in the SLGS rate table that was in effect for a security of comparable maturity on the business day that you began the subscription process.

(e) *How do I complete the subscription process?* The completed subscription must:

- (1) Be dated and submitted by an official authorized to make the purchase;
- (2) Separately itemize securities by the various maturities, interest rates, and first interest payment dates (in the case of notes and bonds);
- (3) Not be more than ten percent above or below the aggregate principal amount originally specified in the subscription;
- (4) Not be paid with proceeds that are derived, directly or indirectly, from the redemption before maturity of SLGS securities subscribed for on or before December 27, 1976;
- (5) Include the certifications required by § 344.2(e)(3)(i); and
- (6) Include the information required under paragraph (b), if not already provided.

(f) *When must I complete the subscription?* BPD must receive a completed subscription on or before 3 p.m., Eastern time, on the issue date.

§ 344.6 How do I redeem a Time Deposit security before maturity?

(a) *What is the minimum time a security must be held?*

(1) *Zero percent certificates of indebtedness of 16 to 29 days.* A zero percent certificate of indebtedness of 16 to 29 days can be redeemed, at the owner's option, no earlier than 15 days after the issue date.

(2) *Certificates of indebtedness of 30 days or more.* A certificate of indebtedness of 30 days or more can be redeemed, at the owner's option, no earlier than 25 days after the issue date.

(3) *Notes or bonds.* A note or bond can be redeemed, at the owner's option, no earlier than 30 days after the issue date.

(b) *Can I request partial redemption of a security balance?* You may request partial redemptions in any whole dollar amount; however, a security balance of less than \$1,000 must be redeemed in total.

(c) *Do I have to submit a request for early redemption?* Yes. An official authorized to redeem the securities before maturity must submit an electronic request in SLGSafe. The request must show the Taxpayer Identification Number of the issuer, the security number, and the dollar amount of the securities to be redeemed. Upon submission of a request for redemption before maturity of a security subscribed for on or after the date of publication of the final rule, the request must include a yield certification under § 344.2(e)(3)(ii). BPD must receive the request no less than 14 days and no more than 60 days before the requested redemption date. You cannot cancel the request.

(d) *How do I calculate the amount of redemption proceeds for subscriptions on or after October 28, 1996?* For securities subscribed for on or after October 28, 1996, the amount of the redemption proceeds is calculated as follows:

(1) *Interest.* If a security is redeemed before maturity on a date other than a scheduled interest payment date, Treasury pays interest for the fractional interest period since the last interest payment date.

(2) *Redemption value.* The remaining interest and principal payments are discounted by the current Treasury borrowing rate for the remaining term to maturity of the security redeemed. This may result in a premium or discount to the issuer depending on whether the

current Treasury borrowing rate is unchanged, lower, or higher than the stated interest rate of the early-redeemed SLGS securities. There is no market charge for the redemption of zero interest Time Deposit securities subscribed for on or after October 28, 1996. Redemption proceeds in the case of a zero-interest security are a return of the principal invested. The formulas for calculating the redemption value under this paragraph, including examples of the determination of premiums and discounts, are set forth in Appendix B of this part.

(e) *How do I calculate the amount of redemption proceeds for subscriptions from September 1, 1989, through October 27, 1996?* For securities subscribed for from September 1, 1989, through October 27, 1996, the amount of the redemption proceeds is calculated as follows:

(1) *Interest.* If a security is redeemed before maturity on a date other than a scheduled interest payment date, Treasury pays interest for the fractional interest period since the last interest payment date.

(2) *Market charge.* An amount shall be deducted from the redemption proceeds if the current Treasury borrowing rate for the remaining period to original maturity exceeds the rate of interest originally fixed for such security. The amount shall be the present value of the future increased borrowing cost to the Treasury. The annual increased borrowing cost for each interest period is determined by multiplying the principal by the difference between the two rates. For notes and bonds, the increased borrowing cost for each remaining interest period to original maturity is determined by dividing the annual cost by two. Present value is determined by using the current Treasury borrowing rate as the discount factor. When you request a redemption date that is less than thirty days before the original maturity date, we will apply the rate of a one month security as listed on the SLGS rate table issued on the day you make a redemption request. The market charge under this paragraph can be computed by using the formulas in Appendix A of this part.

(f) *How do I calculate the amount of redemption proceeds for subscriptions from December 28, 1976, through August 31, 1989?* For securities subscribed for from December 28, 1976, through August 31, 1989, the amount of the redemption proceeds is calculated as follows:

(1) *Interest.* Interest for the entire period the security was outstanding shall be recalculated if the original interest rate of the security is higher

than the interest rate that would have been set at the time of the initial subscription had the term of the security been for the shorter period. If this results in an overpayment of interest, we will deduct from the redemption proceeds the aggregate amount of such overpayments, plus interest, compounded semi-annually thereon, from the date of each overpayment to the date of redemption. The rate used in calculating the interest on the overpayment will be one-eighth of one percent above the maximum rate that would have applied to the initial subscription had the term of the security been for the shorter period. If a bond is redeemed before maturity on a date other than a scheduled interest payment date, no interest is paid for the fractional interest period since the last interest payment date.

(2) *Market charge.* An amount shall be deducted from the redemption proceeds in all cases where the current Treasury borrowing rate for the remaining period to original maturity of the security prematurely redeemed exceeds the rate of interest originally fixed for such security. You can compute the market charge under this paragraph by using the formulas in Appendix A of this part.

(g) *How do I calculate the amount of redemption proceeds for subscriptions on or before December 27, 1976?* For bonds subscribed for on or before December 27, 1976, the amount of the redemption proceeds is calculated as follows:

(1) *Interest.* The interest for the entire period the bond was outstanding shall be recalculated if the original interest rate at which the bond was issued is higher than an adjusted interest rate reflecting both the shorter period during which the bond was actually outstanding and a penalty. The adjusted interest rate is the Treasury rate which would have been in effect on the date of issue for a marketable Treasury bond maturing on the semi-annual maturity period before redemption reduced by a penalty which must be the lesser of:

(i) One-eighth of one percent times the number of months from the date of issuance to original maturity, divided by the number of full months elapsed from the date of issue to redemption; or

(ii) One-fourth of one percent.

(2) *Deduction.* We will deduct from the redemption proceeds, if necessary, any overpayment of interest resulting from previous payments made at a higher rate based on the original longer period to maturity.

Subpart C—Demand Deposit Securities

§ 344.7 What are Demand Deposit securities?

Demand Deposit securities are one-day certificates of indebtedness that are automatically rolled over each day until you request redemption.

(a) *How are the SLGS rates for Demand Deposit securities determined?* Each security shall bear a variable rate of interest based on an adjustment of the average yield for three-month Treasury bills at the most recent auction. A new rate is effective on the first business day following the regular auction of three-month Treasury bills and is shown in the SLGS rate table. Interest is accrued

and added to the principal daily. Interest is computed on the balance of the principal, plus interest accrued through the preceding day.

(1) *How is the interest rate calculated?*

(i) First, you calculate the annualized effective Demand Deposit rate in decimals, designated “I” in Equation 1, as follows:

$$r = \left[\left(\frac{100}{P} \right)^{Y/DTM} - 1 \right] \times (1 - MTR) - TAC \quad (\text{Equation 1})$$

where:

I = Annualized effective Demand Deposit rate in decimals.

P = Average auction price for the most recently auctioned 13-week Treasury bill, per hundred, to three decimals.

Y = 365 (if the year following issue date does not contain a leap year day) or 366 (if the year following issue date does contain a leap year day).

DTM = The number of days from date of issue to maturity for the most recently auctioned 13-week Treasury bill.

MTR = Estimated marginal tax rate, in decimals, of purchasers of tax-exempt bonds.

TAC = Treasury administrative costs, in decimals.

(ii) Then, you calculate the daily factor for the Demand Deposit rate as follows:

$$DDR = (1 + I)^{1/Y} - 1 \quad (\text{Equation 2})$$

(2) *Where can I find additional information?* Information on the estimated average marginal tax rate and costs for administering Demand Deposit securities, both to be determined by Treasury from time to time, will be published in the **Federal Register**.

(b) *What happens to Demand Deposit securities during a Debt Limit Contingency?* At any time the Secretary determines that issuance of obligations sufficient to conduct the orderly financing operations of the United States cannot be made without exceeding the statutory debt limit, we will invest any unredeemed Demand Deposit securities in special ninety-day certificates of indebtedness. Funds invested in the ninety-day certificates of indebtedness earn simple interest equal to the daily factor in effect at the time Demand Deposit security issuance is suspended, multiplied by the number of days outstanding. When regular Treasury borrowing operations resume, the ninety-day certificates of indebtedness, at the owner's option, are:

(1) Payable at maturity;

(2) Redeemable before maturity, provided funds are available for redemption; or

(3) Reinvested in Demand Deposit securities.

§ 344.8 What other provisions apply to subscriptions for Demand Deposit securities?

(a) *When is my subscription due?* The subscriber must fix the issue date of each security in the subscription. The issue date cannot be changed. The issue date must be a business day. The issue date cannot be more than sixty days after the date BPD receives the subscription. If the subscription is for \$10 million or less, BPD must receive the subscription at least five days before the issue date. If the subscription is for more than \$10 million, BPD must receive the subscription at least seven days before the issue date.

(b) *How do I start the subscription process?* A subscriber starts the subscription process by entering into SLGSafe the following information:

- (1) The issue date;
- (2) The total principal amount;
- (3) The issuer's name and Taxpayer Identification Number;
- (4) The title of an official authorized to purchase SLGS securities;
- (5) A description of the municipal bond issue;
- (6) The certification required by § 344.2(e)(1), if the subscription is submitted by an agent of the issuer; and
- (7) The certification required by § 344.2(e)(2) (relating to authorization of the state or local bonds).

(c) *Under what circumstances can I cancel a subscription?* You cannot cancel a subscription unless you establish, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option.

(d) *How do I change a subscription?* You can change a subscription on or before 3 p.m., Eastern time, on the issue date. You may change the aggregate

principal amount specified in the subscription by no more than ten percent, above or below the amount originally specified in the subscription.

(e) *How do I complete the subscription process?* The subscription must:

- (1) Be dated and submitted electronically by an official authorized to make the purchase;
- (2) Include the certifications required by § 344.2(e)(3)(i) (relating to yield); and
- (3) Include the information required under paragraph (b) of this section, if not already provided.

§ 344.9 How do I redeem a Demand Deposit security?

(a) *When must I notify BPD to redeem a security?* A Demand Deposit security can be redeemed at the owner's option, if BPD receives a request for redemption not less than:

- (1) 1 business day before the requested redemption date for redemptions of \$10 million or less; and
- (2) 3 business days before the requested redemption date for redemptions of more than \$10 million.

(b) *Can I request partial redemption of a security balance?* You may request partial redemptions in any amount. If your account balance is less than \$1,000, it must be redeemed in total.

(c) *Do I have to submit a request for redemption?* Yes. An official authorized to redeem the securities must submit an electronic request through SLGSafe. The request must show the Taxpayer Identification Number of the issuer, the security number, and the dollar amount of the securities to be redeemed. BPD must receive the request by 3 p.m., Eastern time on the required day. You cannot cancel the request.

Subpart D—Special Zero Interest Securities

§ 344.10 What are Special Zero Interest securities?

Special zero interest securities were issued as certificates of indebtedness

and notes. The provisions of subpart B of this part (Time Deposit securities) apply except as specified in Subpart D of this part. Special Zero Interest securities were discontinued on October 28, 1996. The only zero interest securities available after October 28, 1996, are zero interest Time Deposit

securities that are subject to subpart B of this part.

§ 344.11 How do I redeem a Special Zero Interest Security before maturity?

Follow the provisions of § 344.6(a)–(g) as published in the **Federal Register**, 65 FR 55399, Sept. 13, 2000, except that no market charge or penalty will apply

when you redeem a special zero interest security before maturity.

Dated: September 24, 2004.

Donald V. Hammond,

Fiscal Assistant Secretary.

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