

In addition to considering the views expressed by the commenters to the ANPR, Department staff has also consulted with various regulatory agencies (i.e., staff of the Securities and Exchange Commission (SEC), the Commodities Futures Trading Commission, the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York (FRBNY)) in developing this proposal. We intend to continue to involve interested market participants and the regulatory agencies in the development of the large position regulations through the completion of the rulemaking process. Accordingly, the Department welcomes and strongly encourages market participants to submit comments on the proposed rules and any suggestions for reducing burdens on the industry while still achieving the objectives of the rules.

#### *Balancing of Regulatory and Market Needs*

The Department has attempted 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. For the following reasons, we believe that the rules being proposed successfully achieve this balance.

First, the proposed rules envision reports to be submitted only in response to a specific request by the Treasury for large position information on a particular Treasury security issue. Under this approach, reporting should 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.

Second, the proposed rules establish a minimum large position threshold of \$2 billion below which the Treasury would not request large position reports. As a result, we believe that very few entities would be required to file large position reports.

Third, the 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.

Fourth, for those entities currently subject to recordkeeping rules of the SEC, the Treasury or the bank regulatory agencies, the proposed rules impose only minor additional recordkeeping requirements and only if certain conditions are present. Finally, the proposed rules adopt 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>7</sup> This should reduce the time and costs that affected entities will need for training their employees on the large position rules.

#### *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 only apply to entities that hold or control (i.e., exercise investment discretion) 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 being proposed as part of this rulemaking.

The Department reiterates 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 the Treasury rules. In addition, the proposed rules do not establish trading or position limits or require the identification of large traders or the reporting of large trades. Finally, 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.<sup>8</sup>

#### *II. Comments Received in Response to ANPR*

Seven comment letters were received in response to the ANPR. The letters were submitted by two trade organizations, one primary dealer, a Federal Reserve Bank, a bank regulatory agency, a commercial bank and an insurance company.<sup>9</sup> While all comments are summarized below, each

letter did not necessarily address all aspects of the ANPR.

Six commenters were largely supportive of a large position reporting system provided that such a reporting system would not be overly burdensome for market participants. However, one commenter opposed the concept of large position reporting entirely. This party believed that "the current auction reporting rules have already addressed adequately the prior problems with market manipulation," and that an unintended consequence of large position rules could be fewer participants in the government securities market, which, in turn, would result in higher borrowing costs.

#### *On-Demand vs. Automatic Reporting*

Five commenters supported an on-demand reporting system which would be triggered by specific requests from the Treasury for large position information on a particular Treasury security. One respondent, however, favored an automatic, regular reporting system triggered whenever a reporting entity's holdings in a security reached a certain threshold.

The primary reason expressed by those commenters favoring an on-demand reporting system was that this approach would be significantly less burdensome and costly than an automatic reporting system. Many commenters noted that an automatic reporting method would impose more complex systems development requirements and greater operational costs due to the need for daily monitoring of positions across multiple securities. In addition, automatic reporting could create a disincentive to buy and hold large positions that exceed a fixed reporting threshold. Finally, on-demand reporting was viewed by several respondents as being better able to address price distortions and provide more useful information since the request for large position information would be targeted to specific market situations and security issues.

The respondent favoring an automatic reporting system argued that on-demand reporting "would be difficult and costly to communicate to all relevant parties." The commenter also felt that on-demand requests might trigger unwanted market reactions, while a regular reporting system "would provide more consistent monitoring of the market and would be less confusing to the market over time."

#### *Definition of Reporting Entity*

Six commenters were in agreement that the definition of "reporting entity" should conform with the definition of "bidder" as defined in the uniform

<sup>7</sup> Uniform Offering Circular for the Sale and Issue of Treasury Bills, Notes and Bonds, 31 CFR Chapter II, Subchapter B, Part 356.

<sup>8</sup> 5 U.S.C. 552(b)(3)(B).

<sup>9</sup> Public Securities Association, Investment Company Institute, Chemical Securities Inc., the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System, Chemical Bank, and CNA Insurance Companies, respectively.