

## DEPARTMENT OF THE TREASURY

## Fiscal Service

## 31 CFR Part 225

RIN-1510-AA36

**Acceptance of Bonds Secured By Government Obligations in Lieu of Bonds With Sureties**

**AGENCY:** Financial Management Service, Fiscal Service, Treasury.

**ACTION:** Final rule.

**SUMMARY:** The Financial Management Service (Service) is issuing this final rule to revise 31 CFR Part 225, which governs the acceptance of bonds secured by Government obligations in lieu of bonds with sureties. This final rule specifically addresses the mechanics of pledging book-entry Government obligations, and clarifies existing requirements for accepting bonds secured with Government obligations. These revisions are intended to provide greater clarity and flexibility by replacing obsolete references and unnecessary requirements with current references and requirements. In addition, the rule expands the use to which the proceeds of pledged Government obligations may be applied in the event of a default in performance.

**EFFECTIVE DATE:** March 1, 1999.

**ADDRESSES:** Cash Management Policy and Planning Division, Financial Management Service, Room 420, 401 14th St., S.W., Washington, D.C. 20227.

**FOR FURTHER INFORMATION CONTACT:** Mary Bailey, Financial Program Specialist, at (202) 874-6749; Cynthia L. Johnson, Director, Cash Management Policy and Planning Division, at (202) 874-6590; or Marc I. Seldin, Principal Attorney, at (202) 874-6680. A copy of this final rule is available on the Service's web site at the following address: <http://www.fms.treas.gov/regs.html>.

**SUPPLEMENTARY INFORMATION:****Background**

Persons required by Federal law to give an agency a surety bond instead may provide a bond secured by Government obligations. To assist agencies in reviewing and accepting such bonds, the Secretary of the Treasury (the Secretary) promulgated regulations codified at 31 CFR Part 225, which set forth requirements applicable to bonds secured by Government obligations.

The regulations originally covered bonds secured by Government obligations in definitive (paper) form.

However, since the regulations were last revised, the form of newly issued Government obligations pledged under this part has changed from definitive to book-entry. This revision covers these newly issued book-entry Government obligations and updates, clarifies and simplifies the requirements dealing with existing definitive Government obligations.

In addition, this revision provides that in the event of a default, the proceeds from the sale of pledged Government obligations generally will be available to satisfy any claim of the United States. The current rule limits the application of the proceeds to damages arising out of the default.

On November 15, 1996, the Service published in the **Federal Register** a notice of proposed rulemaking (NPRM) addressing these changes (61 FR 58493). This final rule was delayed to allow coordination and ensure consistency with other provisions of Title 31, some of which were in the process of being revised.

In addition, the Bureau of the Public Debt (Public Debt), a component of the Department of the Treasury's Fiscal Service, has the regulatory and procedural responsibility for establishing acceptable collateral and determining the collateral valuation for all Fiscal Service collateral programs, including collateral acceptability and valuation for this part. Public Debt intends to issue a regulation as a new part in Title 31 addressing collateral eligibility and valuation matters which will directly impact the Government obligations eligible for use under this part. A subsection in this part (§ 225.3(e)) has been reserved to insert the appropriate references to the new Public Debt Part.

**Comments on the Proposed Rule**

The Service received one comment letter on the NPRM from a component of a Federal agency questioning the NPRM's provision that in the event of a default, the proceeds from the sale of pledged Government obligations will be available to satisfy any claim of the United States against the obligor. The commenter stated that such a policy would conflict with its agency's authorities.

The NPRM provision is an expansion of the current rule, which limits the application of such proceeds to damages arising out of the default. The expansion is supported by Federal common law, the Debt Collection Act of 1982, as amended, and the Federal Claims Collection Standards, which provide the Government a right of offset. For example, upon default, in the event the

bond official receives excess proceeds from the sale of pledged Government obligations, remittance of such proceeds to the obligor would constitute a Federal payment subject to administrative offset. In response to the commenter's concerns, however, the provision has been modified to apply only when not otherwise provided by law.

**Section-by-Section Analysis**

Editorial changes have been made throughout the part. Substantive changes that were made to portions of §§ 225.2, 225.3, 225.4, and 225.5 are explained below.

**Section 225.2—Definitions**

Changes have been made in the Definitions section to standardize terms used throughout Title 31 of the Code of Federal Regulations.

In the definitions of "Bearer" and "Definitive," the term "Government" has been inserted before the term "obligation" to mirror the underlying statutory definition contained in 31 U.S.C. 9301, as amended.

The definition for "Book-entry" now mirrors the definition of the same term in 31 CFR Part 356 at § 356.2 since the term is used in the same sense in both parts.

A definition for "Depository" has been added since the term is used in this part.

The definition for "Government obligation" now mirrors the underlying statutory definition contained in 31 U.S.C. 9301, as amended.

A definition for "Person" has been added which mirrors the definition in the underlying statute, 31 U.S.C. 9301, as amended.

The definition for "Pledge" has been updated to be consistent with related regulations, such as Public Debt's TRADES (Treasury/Reserve Automated Debt Entry System) regulations codified at 31 CFR Part 357.

**Section 225.3—Pledge of Government obligations in lieu of a bond with surety or sureties**

The first sentence of § 225.3(a) now refers to the underlying statute defining the term "Government obligation," 31 U.S.C. 9301, as amended.

The statutes underlying this rule, 31 U.S.C. 9301 and 9303, as amended, define the characteristics of acceptable Government obligations without providing additional information. Further clarification has been added to the end of § 225.3(a) stating that the Secretary will designate classes of acceptable Government obligations. Such designation will occur in a

rulemaking to be published by Public Debt in a new part to Title 31.

The term "par" has been replaced in § 225.3(c) by a reference to the underlying statute, 31 U.S.C. 9303, as amended.

Subsection 225.3(e) has been reserved for reference to the new Public Debt regulations regarding collateral valuation.

#### *Section 225.4—Pledge of book-entry Government obligations*

The first sentence of § 225.4(a) has been modified for consistency with the Public Debt's TRADES regulations (see 31 CFR Part 357). Clarification is added by referring to a depository (defined in § 225.2) since it is generally only depositories that may have Government obligation accounts on the books of a Federal Reserve Bank.

In § 225.4(a), a phrase, "or the bond official," has been added to the list of who shall arrange a pledge. This has been done to reflect account structures at the Federal Reserve. Section 225.4(b) has been modified for the same reason with the addition of the phrase "or a depository acting as agent or sub-agent for the obligor."

In §§ 225.4(a), (b), and (c), the phrase "make an appropriate entry in the records" and similar phrases has been replaced with "transfer Government obligations to an account for the benefit of the bond official" and similar phrases. This change is made to reflect the operations of the Federal Reserve's Book-Entry System.

The reference in § 225.4(c) has been revised for consistency with Public Debt's TRADES regulations (see, e.g., 31 CFR § 357.12).

#### *Section 225.5—Pledge of definitive Government obligations*

In § 225.5(e), the reference to the Public Debt regulation, Part 306, has been updated consistent with other conforming changes related to Public Debt's TRADES regulations.

#### **Rulemaking Analysis**

It has been determined that this regulation is not a significant regulatory action as defined in E.O. 12866. Therefore, a Regulatory Assessment is not required.

It is hereby certified pursuant to the Regulatory Flexibility Act that this revision will not have a significant economic impact on a substantial number of small entities. These regulations authorize persons to pledge bonds secured by Government obligations in lieu of bonds with sureties. Consequently, these regulations provide additional options

to persons pledging collateral, as well as a flexible regulatory scheme. Accordingly, a Regulatory Flexibility Act analysis is not required.

#### **List of Subjects in 31 CFR Part 225**

Fiscal Service, Government obligations, Surety bonds.

For the reasons set forth in the preamble, 31 CFR Part 225 is revised to read as follows:

#### **Part 225—ACCEPTANCE OF BONDS SECURED BY GOVERNMENT OBLIGATIONS IN LIEU OF BONDS WITH SURETIES.**

Sec.

225.1 Scope.

225.2 Definitions.

225.3 Pledge of Government obligations in lieu of a bond with surety or sureties.

225.4 Pledge of book-entry Government obligations.

225.5 Pledge of definitive Government obligations.

225.6 Payment of interest.

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225.8 Bond official duties and responsibilities.

225.9 Return of Government obligations to obligor.

225.10 Other agency practices and authorities.

225.11 Courts.

**Authority:** 12 U.S.C. 391; 31 U.S.C. 321; 31 U.S.C. 9301; 31 U.S.C. 9303.

##### **§ 225.1 Scope.**

The regulation in this part applies to Government agencies accepting bonds secured by Government obligations in lieu of bonds with sureties. The Financial Management Service (FMS) is the representative of the Secretary of the Treasury (Secretary) in all matters concerning this part unless otherwise specified. The Commissioner of the FMS may issue procedural instructions implementing this regulation.

##### **§ 225.2 Definitions.**

For purposes of this part:

*Agency* means a department, agency, or instrumentality of the United States Government.

*Authenticate instructions* means to verify that the instructions received are from a bond official.

*Bearer* means that ownership of a Government obligation is not recorded. Title to such an obligation passes by delivery without endorsement and without notice. A bearer obligation is payable on its face to the holder at either maturity or call.

*Bond* means an executed written instrument, which guarantees the fulfillment of an obligation to the United States and sets forth the terms, conditions, and stipulations of the obligation.

*Bond official* means an agency official having authority under Federal law or regulation to approve a bond with surety or sureties and to approve a bond secured by Government obligations.

*Book-entry* means that the issuance and maintenance of a Government obligation is represented by an accounting entry or electronic record and not by a certificate.

*Custodian* means a Federal Reserve Bank or an entity within the United States designated by such Federal Reserve Bank under terms and conditions prescribed by such Federal Reserve Bank, a depository specifically designated by the Secretary of the Treasury for purposes of this part, or such other entities as the Secretary of the Treasury may designate for purposes of this part.

*Definitive* means that a Government obligation is issued in engraved or printed form.

*Depository* includes, but is not limited to:

(1) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) or any bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(2) Any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) or any bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(3) Any savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) or any bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(4) Any insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752) or any credit union which is eligible to make application to become an insured credit union under section 201 of such Act (12 U.S.C. 1781);

(5) Any savings association as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) which is an insured depository institution (as defined in such Act) (12 U.S.C. 1811 *et seq.*) or is eligible to apply to become an insured depository institution under the Federal Deposit Insurance Act (12 U.S.C. 1811 *et seq.*); and

(6) Any agency or branch of a foreign bank as defined in section 1(b) of the International Banking Act, as amended (12 U.S.C. 3101).

*Federal Reserve* means a Federal Reserve Bank and its branches.

*Government obligation* means a public debt obligation of the United States Government and an obligation whose principal and interest is unconditionally guaranteed by the United States Government.

*Obligor* includes, but is not limited to, an individual, a trust, an estate, a partnership, a corporation, and a sole proprietor.

*Officer authorized to certify assignment* means the individual identified as a certifying individual at part 306, subpart F of this title.

*Person* means an individual, a trust, an estate, a partnership, and a corporation.

*Pledge* means a transfer of security interest in a Government obligation to a bond official's agency as collateral in lieu of a bond with a surety or sureties.

*Procedural instructions* means the Treasury Financial Manual, as amended, published by the Financial Management Service.

*Registered* means that ownership of a definitive Government obligation is listed in the issuer's records, and that the obligation is payable at maturity or call to the person in whose name the obligation is inscribed or to that person's assignee.

*Secretary* means the Secretary of the Treasury.

#### **§ 225.3 Pledge of Government obligations in lieu of a bond with surety or sureties.**

(a) *General.* An obligor required by Federal law or regulation to furnish a bond with surety or sureties may give in lieu thereof to a bond official any security acceptable under 31 U.S.C. 9301, as amended. The Secretary will designate classes of Government obligations acceptable under this part.

(b) *Bond.* The bond, at a minimum, shall irrevocably authorize the bond official to collect, sell, assign, or transfer such Government obligations and any interest retained therefrom in the event of the obligor's default in performing any of the terms, conditions, or stipulations of such bond. Unless otherwise provided by law, the bond shall authorize the bond official to apply the proceeds from the sale, assignment, or transfer of such Government obligations, in whole or in part, to satisfy any costs incurred by the United States related to the default, and to apply any excess proceeds to satisfy any other claim of the United States against the obligor. The bond shall not include any obligations on custodians which are inconsistent with, or in addition to, the obligations in this part. The bond will provide that the bond official may retain any interest accruing upon any Government obligations, or

direct that such interest be retained by the custodian.

(c) *Amount of Government obligations.* The obligor shall pledge to the bond official Government obligations valued as required by 31 U.S.C. 9303, as amended.

(d) *Avoiding frequent substitutions.* To avoid the frequent substitution of Government obligations, the bond official may reject Government obligations which mature, or are redeemable, within one year from the date they are pledged to the bond official.

(e) *Reserved.*

#### **§ 225.4 Pledge of book-entry Government obligations.**

(a) *General.* Except as otherwise provided by the Secretary in procedural instructions, an obligor, or a depository acting as agent or sub-agent for the obligor, or the bond official, shall arrange a pledge pursuant to the prior agreement and approval of the bond official, of book-entry Government obligations. The Government obligations must be transferred to an account for the benefit of the bond official. The custodian holding the Government obligations is not required to establish that the agreement and approval of the bond official has been obtained prior to such a transfer.

(b) *Receipt.* Upon the transfer of Government obligations to an account for the benefit of the bond official, the custodian will promptly issue a receipt or an activity statement, or both, to the bond official and to the obligor or a depository acting as agent or sub-agent for the obligor.

(c) *Effect of the transfer.* Book-entry Government obligations credited to an account for the benefit of the bond official shall have the effect as provided in part 357 of this title, or in other applicable regulations.

#### **§ 225.5 Pledge of definitive Government obligations.**

(a) *Type and assignment.* Definitive Government obligations may be in bearer or registered form, and shall be owned by the obligor.

(1) *Bearer Government obligations.* The obligor shall pledge bearer Government obligations to the bond official with all unmatured interest coupons attached.

(2) *Registered Government obligations; assignment.* The obligor shall pledge registered Government obligations in the obligor's name to the bond official by assignment in accordance with subpart F of part 306 of this title and other codified procedures for issuers that apply to

assignment of the registered Government obligations, except that, when so authorized under such procedures, all assignments shall be made in blank.

(b) *Delivery to bond official; receipt.* All deliveries of definitive Government obligations from the obligor to the bond official under this part shall be made at the risk and expense of the obligor. Upon receipt of definitive Government obligations, the bond official will issue the obligor a receipt.

(c) *Risk of loss; safekeeping.* All definitive Government obligations held by the bond official will be held at the risk of the bond official. The bond official will keep safe all definitive Government obligations and may place them with a custodian.

(d) *Delivery to custodian; receipt.* If the bond official is in receipt of definitive Government obligations, and then places those obligations with a custodian, the expense and risk of loss in delivery will rest with the bond official. Upon the placement of definitive Government obligations with a custodian, the custodian will issue the bond official a receipt. All definitive Government obligations held by the custodian will be held at the risk of the custodian.

(e) *Conversion to book-entry.* (1) Treasury bonds, notes, certificates of indebtedness, or bills deposited with a Federal Reserve Bank under this part may be converted into book-entry Treasury obligations in accordance with part 306 of this title, and the pertinent provisions of that part shall apply to such Treasury obligations.

(2) When converting definitive Government obligations to book-entry form, a Federal Reserve Bank will act pursuant to, and in accordance with, book-entry procedures for issuers that apply to the definitive Government obligations pledged to the bond official's agency, including those set forth in part 306 of this title.

#### **§ 225.6 Payment of interest.**

(a) *General.* Except as otherwise provided in this section and § 225.7(b), interest accruing upon Government obligations pledged to a bond official's agency in accordance with this part will be remitted to the obligor or a depository acting as agent or sub-agent for the obligor.

(b) *Default.* If the bond official determines that the obligor has defaulted, the bond official will retain any interest accruing upon Government obligations pledged to the bond official's agency or direct the custodian, in accordance with this part, to retain such interest. Unless otherwise

provided by law, such interest will be available to satisfy any costs incurred by the United States related to the default, and any excess proceeds will be available to satisfy any other claim of the United States against the obligor.

**§ 225.7 Custodian duties and responsibilities.**

(a) *General.* A custodian shall authenticate instructions received from a bond official and shall act in accordance with such authenticated instructions. The custodian assumes no liability and is without liability of any kind for acting in accordance with such authenticated instructions, except for the custodian's failure to exercise ordinary care. By providing a bond secured by Government obligations in lieu of a bond with surety or sureties, an obligor agrees not to hold either the custodian or the Secretary liable or responsible for the actions or inactions of a bond official or for carrying out a bond official's authenticated instructions.

(b) *Interest.* Absent authenticated instructions from the bond official to retain interest, interest received by the custodian on Government obligations pledged to the bond official's agency in accordance with this part will be remitted in the regular course of business to the obligor or to a depository acting as agent or sub-agent for the obligor.

(c) *Principal.* Absent authenticated instructions from the bond official to retain the proceeds of matured Government obligations, a custodian will release to the obligor proceeds from matured Government obligations only if the obligor has deposited Government obligations acceptable under 31 U.S.C. 9301, as amended, in substitution for those which have matured.

(d) *Liquidation of Government obligations.* A custodian will collect, sell, assign, or transfer Government obligations, including any interest therefrom, only in accordance with a bond official's authenticated instructions.

(e) *Application of proceeds of liquidated Government obligations.* A custodian will apply the proceeds from the collection, sale, assignment, or transfer of Government obligations only in accordance with a bond official's authenticated instructions.

**§ 225.8 Bond official duties and responsibilities.**

The bond official's duties and responsibilities are as follows:

(a) Approving the bond secured by Government obligations after determining its sufficiency;

(b) Verifying ownership of any registered definitive Government obligations given, and ensuring that those Government obligations are properly assigned;

(c) Approving establishment of a book-entry account for the benefit of the bond official;

(d) Providing the custodian, when appropriate, with clear and concise instructions;

(e) Taking all reasonable and appropriate steps to ensure that all procedures or transactions conform with the provisions of this part; and

(f) Notifying the Secretary of the Treasury, or his designee, upon an obligor's default, and, unless otherwise provided by law, applying any part of the proceeds in excess of the amount required to assure payment of any costs incurred by the United States related to the default to satisfy any claim of the United States against the obligor.

**§ 225.9 Return of Government obligations to obligor.**

(a) *General.* Except as provided in paragraph (b) of this section or as otherwise provided in this part, the bond official will return the Government obligations, and any interest retained therefrom, to the obligor, without written application from the obligor, when the bond official determines that the Government obligations are no longer required under the terms of the bond.

(b) *Miller Act Payment Bonds.* The bond official will not return Government obligations to an obligor who has furnished to the bond official a payment bond if:

(1) A person, who supplied the obligor with labor or materials and whom the obligor has not paid, files with the United States Government the application and affidavit provided for in the Miller Act (Act), as amended (40 U.S.C. 270a-270d), and the time provided in the Act for the person to commence suit against the obligor on the payment bond has not expired; or

(2) A person commences a suit against the obligor within the time provided for in the Act, in which case the bond official will hold the Government obligations subject to the order of the court having jurisdiction of the suit; or

(3) The bond official has actual knowledge of a claim against the obligor on the basis of the payment bond, in which case the bond official may return the Government obligations to the obligor when the bond official deems it appropriate.

(c) *Claim of the United States unaffected.* Nothing in this section shall affect or impair the priority of any claim of the United States against Government obligations, or any right or remedy granted by the Miller Act or by this part to the United States in the event of an obligor's default on any term, condition, or stipulation of a bond.

(d) *Return of definitive Government obligations; risk of loss.* Definitive Government obligations to be returned to the obligor will be forwarded at the obligor's risk and expense, either by the bond official, or by a custodian upon receipt of a bond official's authenticated instructions.

**§ 225.10 Other agency practices and authorities.**

(a) *Agency practices.* Nothing in this part shall be construed as modifying the existing practices or duties of agencies in handling bonds, except to the extent made necessary under the terms of this part by reason of the acceptance of bonds secured by Government obligations.

(b) *Agency authorities.* Nothing contained in this part shall affect the authority of agencies to receive Government obligations for security in cases authorized by other provisions of law.

**§ 225.11 Courts.**

Nothing contained in this part shall affect the authority of a court over a Government obligation given as security in a civil action.

Dated: January 26, 1999.

**Richard L. Gregg,**  
Commissioner.

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