

The Treasury Investment Program

Becoming a Note Option Depository



The Federal Reserve System

Dear Cash Manager,

The Treasury Tax and Loan Investment Program has grown dramatically since its inception in 1978. On an average day in 1996, the 1,850 financial institutions participating in the Treasury Investment Program borrowed \$16 billion from the Treasury. While everyone benefits from this program, financial institutions benefit the most by borrowing at 25 basis points below the Federal Funds rate. Continued growth in the Treasury Investment Program is good for financial institutions, the banking system, and the Treasury.

Becoming a Treasury Investment Program “note option” depository allows your institution to retain your customers’ tax deposits at a competitive rate of interest. You may choose to receive additional funds directly from the Treasury through the direct investment and special direct investment programs.

With the implementation of the Electronic Federal Tax Payment System (EFTPS), the financial advantages of participation in the Treasury Investment Program have more of an impact than ever on financial institutions. Most financial institutions that participate in the program as “remittance option” depositories pledge collateral to secure large in-transit tax deposits. These deposits may only occur twice a month. As tax deposits are transitioned to EFTPS, the collateral required to secure those paper-based deposits overnight is no longer needed. This presents a great opportunity for financial institutions to use this excess collateral to secure borrowings from the Department of the Treasury.

The Treasury is proud to have offered the Treasury Investment Program to the financial community for nearly 20 years. We are pleased to be able to provide the enclosed guide which highlights the advantages of being a Treasury Investment Program depository. If you have further questions, the Treasury Tax & Loan representative at your Federal Reserve Bank can help you.



Gerald Murphy
Fiscal Assistant Secretary
Department of the Treasury

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The Treasury Investment Program

The Treasury Investment Program is essentially the U.S. Treasury's savings account with over 1,850 participating financial institutions across the country. On an average day, the Treasury has \$16 billion invested in these institutions from companies depositing employment and other taxes into the program. These institutions, also called note option depositaries, hold onto the funds in an open-ended interest bearing note until the Treasury withdraws or "calls" the funds.

How This Program Can Benefit You

As a note option depositary, your institution will derive two benefits from this program. First, the interest rate that Treasury charges is 25 basis points below the Federal Funds rate. Accordingly, the funds can be loaned in the Federal Funds market, or they may be used for other, more profitable investments. If you are a small institution, Treasury cash managers usually provide you with more lead time before withdrawing, or calling, the funds. This affords you easier management and greater investment flexibility in using the funds.

Secondly, the Treasury Investment Program can provide your institution with a ready source of liquidity. Participating institutions retain their customers' tax deposits as the primary source of funds under the program. Additional funds are offered through the direct investment and special direct investment programs. These funds represent cash balances in excess of those needed by the Treasury for current expenditures and financing activity.

The special direct investment program works the same as the direct investment program except that an institution may hold the collateral to secure these deposits in their own vault, where the deposits are usually held for two or three weeks.

Each note option and direct investment depositary establishes a pre-approved limit or "maximum balance" on the amount of funds they will hold. Note option depositaries must pledge and maintain collateral up to the pre-established limit, but institutions in the direct investment program have to pledge collateral only for the actual balance held. The bottom line is that your institution acquires an easily monitored source of funds at a favorable rate of interest. The example below demonstrates the earnings potential available through the Treasury Investment Program:

<i>1996 Averages</i>		
<i>Investment Program Rate</i>	<i>Federal Funds Rate</i>	<i>1 Month Commercial Paper</i>
5.05%	5.30%	5.43%



The Treasury Investment Program (continued)



The Federal Reserve System recently surveyed participants in the Treasury Investment Program across the country. When asked why they chose to participate, they cited that they were attracted to “the easy investment opportunity,” “the source of dependable funds,” and “the good source of liquidity, especially for a small institution.” One customer said, “no matter how big or small an institution, we would encourage anyone to take a look at this program.”

New EFTPS Program

The Electronic Federal Tax Payment System (EFTPS) is the Federal Government’s new system for collecting business and other taxes. EFTPS utilizes Automated Clearing House (ACH) debit and credit payments as the primary deposit mechanisms, although same day payment options also are available. EFTPS is now the primary method for businesses to remit tax payments to the Federal Government.

What Does This Mean?

If you are currently a remittance option program depository, you traditionally have held your customers’ tax payments overnight before sending them to the Treasury. This is changing as EFTPS eliminates the overnight availability of your customers’ tax deposits.

As more taxpayers make their tax payments through EFTPS, the transaction and dollar volume of Federal Tax Deposit (FTD) funds flowing through institutions in the current paper-based system will continue to decrease, and will result in the loss of the overnight use of those deposits. As this transition occurs, the securities once needed to collateralize the overnight deposits will become available to use as collateral to secure borrowings from the Treasury through the investment program.

In the investment program, tax deposits collected through the EFTPS ACH system are credited to the institution’s note balance and are available for investment. In EFTPS, if a taxpayer requests that the tax payment be remitted on the tax due date, the depository can initiate three types of same-day tax payment mechanisms: Fedwire “value” (typecode 10), “non-value” (1090) message, or ETA Direct Access. Fedwire payments (typecode 10) settle immediately and bypass the institution’s note balance. However, non-value (1090) messages and ETA Direct Access settle through Treasury Tax & Loan (TT&L), similar to the current paper-based FTD system. This allows the institutions to retain these electronic federal tax funds in their note balance!

Becoming a note option depository is simple. The information in the following sections describes what is involved in becoming a note option depository, how funds flow in and out of the account, the tools for you to manage a note account, and what collateral is required. *Once you’ve read it, give us a call to sign up!*

How to Sign Up

Enrolling as a note option depository is a simple process. Your institution must qualify by meeting the requirements of an eligible institution set forth in 31 CFR 203.3 and 203.4. Specifically, to enroll you will need to:

- have an established reserve/clearing account, or a correspondent/respondent relationship with the Federal Reserve, and
- complete a few forms:
 - an Election of Option Form,
 - FMS Form 458 -Financial Institution Agreement and Application for Designation as a Treasury Tax and Loan Depository,¹ and
 - FMS Form 459 - Resolution Authorizing the Financial Institution Agreement and Application for Designation as a Treasury Tax and Loan Depository.²

These forms are available from your local Federal Reserve Bank. Once they have been completed and approved, your local Federal Reserve Bank will notify you that your financial institution has been designated as a TT&L note depository.

How Do You Change from Remittance Option to Note Option?

If your institution is participating in the TT&L program under the remittance option, the “Election of Option” form allows you to switch from the remittance to the note option program. At the same time, you can set a maximum balance on your institution’s note account balance. “ Election of Option” forms received by the Federal Reserve Bank five business days prior to the first day of the new reporting cycle will be effective the first day of the next cycle (the first Thursday of the month). You will be notified by your local TT&L representative of the effective date.

Your Classification

When you enroll as a note option depository your institution will be classified as an “A,” “B,” or “C” note option depository. The criteria for each classification, effective as of May 1, 1997 (and subject to annual review), are the following:

- A** from \$0 to \$10 million of Federal Reserve Bank TT&L application deposits;
- B** more than \$10 million to \$100 million
or
above \$100 million when total deposit liability was \$100 million or less on September 30; or

¹ Not necessary if you already participate in the TT&L program under the remittance option program.

² Ibid.

Getting Started as a Treasury Tax & Loan
Note Option Depository (continued)



- C** above \$100 million and when total deposit liability was more than \$100 million on September 30
- or
- above \$5 billion in total deposit liability (both demand and time) on September 30
- or
- above \$250 million in Maximum Balance.

Class A note option depositaries generally are notified of Treasury calls at least five days in advance of the withdrawal date; class B note option depositaries generally are notified at least three business days in advance. Calls are made as a percentage of the note balance of a designated day. Calls to class C note option depositaries can be as a percentage of the note balance of a designated day. Calls to class C note option depositaries can be with same-day, or one-day notice. Class A and B note option depositaries generally can expect one call per week or every other week. Class C note option depositaries can expect two to three calls a week. This general pattern may vary over the course of the year.

Setting a Maximum Balance

All note option depositaries are required to establish a maximum note balance, normally not less than \$25,000. These institutions can accumulate the daily tax payments that flow through the institution, up to a pre-approved maximum balance. As a note option depository, you can change your maximum balance at any time to meet your investment needs by providing written notification to your Federal Reserve Bank. Any portion of any advice of credit which, when posted at the Federal Reserve Bank, would cause the note balance to exceed this maximum amount will be withdrawn automatically by the Federal Reserve Bank.

As a note option depository, your institution will be required to collateralize the maximum balance at all times.¹ All tax deposits or a portion of the tax deposits up to the maximum balance generally will be available as a source of short-term investment funds. When establishing a maximum balance, you must determine the collateral available to be pledged, as well as consider historical tax payment flows. When your institution's note balance at the Federal Reserve Bank is at or near this maximum, additional collateral may be necessary to cover the in-transit paper federal tax deposits. Remember, your institution's note balance will include payments received through the current paper-based system (Advice of Credits FMS Form 2284) and most tax payments received from EFTPS.

¹ Unless you also enroll as a direct investment depository.

*Getting Started as a Treasury Tax & Loan
Note Option Depository (continued)*

Direct Investment Option

The Treasury periodically invests a portion of its operating cash directly into the note balance of direct investment program participants and credits your reserve/clearing account or a designated correspondent's account. The minimum amount of a direct investment is \$100,000.

If your institution already has enrolled as a note option depository, and also would like to participate in the Direct Investment Program, simply complete an "Offer to Receive Direct Investments" form. Direct investments are distributed solely on the basis of capacity (the difference between your pre-approved maximum note balance and the actual note balance).

Direct investments are distributed among participating institutions according to one of the following types of notification:

- a. One Day Prior Notice – Each institution enrolled for a one-day prior notice will receive notice of a direct investment one business day prior to the day the funds are credited to the note balance.
- b. Same-Day Notice – An institution enrolled for a same-day notice will receive some direct investments for which notification will be issued on the same day that funds are to be credited to the note balance.

A financial institution enrolled as a "same-day notice" participant is enrolled automatically as a "one-day prior notice" participant as well.

Special Direct Investment Option

If your institution participates in the direct investment program, you also are eligible to receive special direct investments. Special direct investments are similar to direct investments, except that the collateral used to secure special direct investments may be held in an off-premise collateral (OPC) arrangement. Your institution must qualify to secure borrowings (advances) from the discount window under the off-premises procedures that the Federal Reserve Bank has established for that purpose.

If your institution wishes to participate in the special direct investment program, you must submit a completed "Application Form for Special Direct Investments" and a completed "Agreement to Secure Special Direct Investment." The Federal Reserve Bank will notify qualified institutions of acceptance and provide instructions to establish the OPC arrangement. When terms of the arrangement are satisfied, institutions will start receiving special direct investments whenever placed by the Treasury. Special direct investments are distributed solely on the basis of special direct investment capacity, (the difference between the dollar value of collateral pledged under the OPC arrangement, and the current special direct investment



*Getting Started as a Treasury Tax & Loan
Note Option Depository (continued)*



balance). As with direct investments, special direct investments can be distributed with a one-day prior notice, or same-day notice, in accordance with the institution's election. Institutions electing the "same-day" notice option automatically are enrolled in the "next-day" notice program.

Special direct investments are added to an institution's note balance as of the calendar day that the funds are credited to the institution's reserve account. Interest accrues on special direct investments as of that date and will be calculated in the same manner as all other interest on funds in the note balances. Announcements and withdrawals of special direct investments are made by the same call-notice practices used for withdrawals from and placement of funds in class C note option depositaries. Special direct investments are withdrawn within 21 days after placement, although at times they may be reinvested for an extended period up to 21 additional days.

The following page highlights the daily flow of funds in a note balance. Tax payments post into the note balance in the form of EFTPS ACH debits or credits, advices of credit, EFTPS non-value (typecode 1090) Fedwires, and Fedline ETA transactions. Investments post into the note balance from the direct investment program or special direct investment program.

Treasury calls reduce a note balance and result in a debit to your institution's reserve account. You have the flexibility in managing the note balance by increasing or decreasing the maximum balance. By increasing the maximum balance, you open your balance to additional deposits. By reducing the maximum balance below the level of your current note balance, you generate an administrative withdrawal, or "drawdown," resulting in a debit to the reserve account and a reduction in the note balance.

Adjustments for overpayments to the Internal Revenue Service (IRS) are credited to your reserve account. Adjustments for underpayments to the IRS are posted to your note balance.

The accompanying chart identifies the time of day when these different payments post to the note account and the reserve account, as well as when you are notified.



Treasury Tax & Loan System

Note Option Flow

I. Tax Payments

EFTPS Tax payment received and submitted via ACH



Post to note balance & credit institution's reserve account by 8:30 a.m. E.T. for credits and 11:00 a.m. E.T. for debits.

Paper FTD/AOC payments



Post to note balance at end of day.

Non-Value Fedwire and ETA received and submitted same day via Fedwire Funds Transfer by 2:00 p.m. local time at the Federal Reserve head office

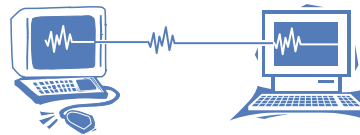


ETA and Non-Value Fedwire transactions settle by end of day.

II. Investments

One Day Direct Investment

Notify institution by noon E.T.



Post to note balance & credit institution's reserve account by 8:30 a.m. E.T.

Same Day Direct Investment

Announce by noon E.T.



Notify & credit institution's reserve account no later than 1:00 p.m. E.T.

III. Treasury Calls

A Calls (five business days)
B calls (three business days)

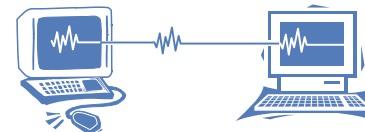
Notify institution by FedLine or mail.



Post to note balance & debit institution's reserve account by 8:30 a.m. E.T.

C Calls (one business day)

Notify institution by Fedline or phone call by noon E.T.



Post to note balance & debit institution's reserve account by 8:30 a.m. E.T. next day.

C Calls (same day)

Notify institution by Fedline or phone call by noon E.T.



Post to note balance & debit institution's reserve account by end of day.

Managing Your Note Balance

The Treasury Tax and Loan (TT&L) system produces a number of useful TT&L management reports available on Fedline. In addition, some Federal Reserve Districts offer automated announcements of planned call and investment actions. You can use these cash management tools to monitor your institution's TT&L activity. Following are the reports and tools available on Fedline.

Statement of Account Activity Report

The TT&L Statement of Account Activity Report provides a listing of all TT&L transactions on a given day. This report provides opening and closing balances, real time transactions (i.e., deposits, adjustments, call actions, and direct investments), closing collateral par, and pledged value amount. The activity report is available on a regular schedule (i.e., daily, weekly, bi-weekly, semi-monthly, or monthly). You can print this report automatically using Fedline, or you can request that it be mailed. Throughout the day, you also can request the Activity Report via Fedline so that you may monitor your note balance and make investment decisions.

Depository Cycle Statement

The TT&L Depository Cycle Statement Report lists all TT&L cycle activity on the current cycle period. It provides the interest charges on the daily average note balances and the accounting entry of the total interest charges for the cycle. This report is available to you on the first day of the following cycle (first Thursday of each month), and can be printed via Fedline or mailed.

Notice of Withdrawal

The TT&L Notice of Withdrawal reports, available on Fedline, provide notification of the total amount slated to be withdrawn from your note balance due to Treasury calls or an institution's request for an administrative drawdown. The following are two types of Notice of Withdrawal reports:

- The Account Status Report provides notification of scheduled same-day or next-day Treasury calls.
- The Administrative Withdrawal Report provides notification of withdrawals from the note balance requested by the institution, and is available on the day of the institution's request.

Notice of Deposits

The TT&L Notice of Deposits Report, available on Fedline, consists of direct investment and special direct investment amounts deposited to your institution's note balance by the Treasury.



Managing Your Note Balance (continued)



- Direct Investment Reports provide notification of the Treasury funds directly invested into the note balance either same day or next day.
- Special Direct Investment Reports provide notification of special direct investments.

Other Cash Management Tools

The Federal Reserve Bank also provides other cash management tools to monitor TT&L transactions and other entries posting to the reserve account via Fedline. One such tool is the Account Balance Monitoring System (ABMS). This is a free service which allows you to inquire about overall account balances and monitor the occurrence of daylight overdrafts. TT&L transactions are reported under the “OTHER AVAIL:” column. You can request the Daylight Overdraft Inquiries report, which provides information on non-Fedwire transactions processed to the reserve account. You also can request IAS/DFI Account Inquiries report, which provides specific balance information related to your reserve account.

Telephone Notification

Some Federal Reserve Banks provide automated announcements of scheduled Treasury calls and direct investments. Note option depositaries can hear announcements of the date of scheduled Treasury calls or direct investments, and the percentage to be called or invested. Contact your local Federal Reserve Bank for the local phone number and availability of this service.

Collateral Requirements

Pledging Collateral

To pledge collateral for a Treasury Tax & Loan (TT&L) account and note balance, your financial institution must establish its own safekeeping account on the books of the Federal Reserve Bank where your TT&L account and note balance is maintained. This account ensures that the funds posting through your TT&L account and note balance are secured.

A pledge of collateral is required for all amounts in the TT&L account in excess of the insurance coverage, and all deposits in the note account. You must collateralize at 100% of your institution’s established maximum note balance at all times unless your institution participates in the direct investment or special direct investment program. Under the special direct investment program, your institution will receive investments up to the recognized value of collateral pledged.

Collateral Requirements (continued)

This affords direct investment participants an opportunity to better manage their collateral by shifting it in and out of the program depending on the amount of Treasury funds available at any point in time. As a direct investment participant, you should be ready to pledge additional collateral up to your institution's maximum note balance, plus any in-transit paper federal tax deposits, to secure funds credited to the note balance through the tax payment or direct investment process.

Collateral eligible for TT&L and note balances is specified by the Treasury. This information is available from your local Federal Reserve Bank representative. The values applied to TT&L collateral will be consistent with the Federal Reserve System guidelines for assets pledged at the discount window.

Forms of Pledged Collateral

Acceptable collateral can be pledged in book-entry form on the books of your Federal Reserve Bank or in definitive form either at the Federal Reserve Bank or with a qualified third party custodian.

Book-Entry Collateral

Book-entry securities, both Treasury and government agency securities, can be deposited in a collateral account at your Federal Reserve Bank. You must contact your local Federal Reserve Bank to establish a TT&L book-entry collateral account.

Definitive Collateral

Definitive collateral consists of securities represented by actual documents. This can include securities in bearer or registered form (such as municipal securities and SBA certificates), or customer notes (such as commercial loans). You may hold definitive collateral for safekeeping in any Federal Reserve Bank vault subject to that Bank's approval. A Federal Reserve Bank (the custodian) that holds definitive collateral for another Federal Reserve Bank will provide a trust receipt to the Federal Reserve Bank holding the TT&L account (the administrator).

In certain instances, definitive collateral may be held off-premises by designated third party or fourth party custodians. There are institutions throughout the U.S. that have been designated by a Federal Reserve Bank as authorized third-party custodians. A third party custody agreement establishes procedures for the pledging of collateral by you (the pledgor) to secure the note balance. Physical possession of the pledged collateral is in a second financial institution (the custodian) acting as an agent of the Federal Reserve Bank.

The Depository Trust Company (DTC) is a national clearing house for the settlement of trades in corporate equity and debt securities and municipal bonds. It also performs



Collateral Requirements (continued)



securities custody services for its participating banks, broker-dealers, and clearing agencies. The Federal Reserve Banks have executed a third-party agreement with the DTC that allows DTC participants to pledge certain types of assets held at DTC (as a “fourth party” custodian). Non-participants of DTC may also pledge DTC-held securities through a direct DTC participant. Prior approval, including the execution of a letter of agreement, is required before an institution may pledge collateral to the Federal Reserve Bank through DTC.

Collateral also can be held on your premises if you are a note option depository participating in the special direct investment program.

Monitoring Pledged Collateral

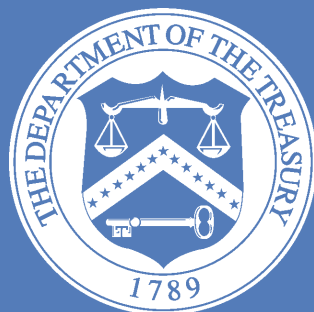
In order to ensure that your TT&L account maintains the balance to cover the amount of your federal tax deposits, the TT&L system at the Federal Reserve Bank provides information that allows us to monitor the daily volume against the pledged collateral. When your tax deposit volume exceeds the amount of collateral you have on pledge, your account becomes collateral deficient. We will contact you to deposit additional collateral. For more information, please contact your local Federal Reserve Bank TT&L representative.

Conclusion

Your institution’s participation in the Treasury Investment Program will give you a unique investment opportunity. Modest levels of funds management can result in a sound return on your investment. Additionally, with the advent of EFTPS, becoming a note option depository will enable you to obtain maximum benefit from your existing collateral.

Your local Federal Reserve Bank account or TT&L representatives are always available to spend time with you going into more detail on the program and its benefits. Please call them in order to begin participating in the Treasury Investment Program soon.

Atlanta
Boston
Chicago
Cleveland
Dallas
Kansas City
Minneapolis
New York
Philadelphia
Richmond
St. Louis
San Francisco



The Federal Reserve System