Trading Practice Guidelines for Treasury's Inflation-Indexed Securities

A. Introduction

Set forth below are The Bond Market Association's recommended trading practice guidelines for U.S. Treasury Inflation-Indexed Securities ("Inflation-Indexed Securities"). The Association believes that these guidelines will help establish standard trading, clearance and settlement practices in Inflation-Indexed Securities that are consistent with current market practices and needs, while preserving flexibility where needed. The Association further believes that these guidelines will improve market efficiencies for Inflation-Indexed Securities.

The trading practice guidelines are recommendations only and are intended for Association member firms in order to promote the smooth functioning of the market for these securities. The recommendations do not and should not restrict the flexibility of counterparties to negotiate the specific terms of any particular transaction.

As with other Association trading practice guidelines, these guidelines are recommended, voluntary standards that are intended to apply to transactions between and among Association members. The Association recognizes, however, that many of its guidelines are widely observed, also on a voluntary basis, by a variety of other market participants. It is anticipated that these guidelines would also be used by such other market participants for the same reasons that motivate the Association's members: namely, the greater market efficiency that results from the broad application and common adherence to uniform standards governing the trading, clearance and settlement of U.S. Treasury securities.

B. Guidelines

1. Price Quotations

(a.) During the when-issued period before the coupon is set by Treasury, Inflation-Indexed Securities should be quoted on a real yield basis (i.e., unadjusted for inflation).

(b.) Inflation-Indexed Securities should be quoted with a dollar price, unadjusted for inflation. This price is also referred to as the "clean price."

(c.) Trades in STRIPS (Separate Trading of Registered Interest and Principal of Securities) should be quoted on real yield basis (i.e., unadjusted for inflation). Real yield should be calculated for STRIPS using a discounted cash flow analysis (that is unadjusted for inflation) based on the original par amount of the securities and the stated coupon, also unadjusted for inflation.

2. Good Delivery Guidelines

The Bond Market Association's current Good Delivery Guidelines for U.S. Treasury securities will also apply to Inflation-Indexed Securities. In accordance with the policy of the Board of Governors of the Federal Reserve System, the Good Delivery Guidelines require that for secondary market transactions involving book-entry Fedwire transfers greater than or equal to

$50 million par value, delivering parties must accept deliveries in amounts equal to $50 million par value. For transactions not wholly divisible by $50 million par value, the remainder can be delivered without regard to sequence. Comparisons and/or confirmations should correspond to the par value amounts delivered under this guideline.

3. Settlement Conventions

Regular way settlement for Inflation-Indexed Securities will be next day. Thus, unless the parties to a trade otherwise agree, all trades will be assumed to be executed for next day settlement. For purposes of these Guidelines, all trades that settle in a longer time frame than next day shall be considered forward trades.

4. Confirmation Recommendations

(a.) Regular Way Trades

Each party to a regular way transaction in an Inflation-Indexed Security should mail or otherwise send a confirmation, in writing or as otherwise agreed and in accordance with market practice, of the transaction to the other party on the trade date.

(b.) Forward Trades

(i) Each party to a forward transaction in an Inflation-Indexed Security should mail or otherwise send a written confirmation, in writing or as otherwise agreed and in accordance with market practice, of the transaction to the other party on the trade date. In addition to any applicable regulatory requirements, the confirmation should specify either the Index Ratio or the inflation-adjusted principal amount of the security as of the settlement date.

(ii) In the event the applicable CPI number(s) has/have not been published by the Bureau of Labor Statistics, U.S. Department of Labor, or the Treasury Department, as of the trade date in order to determine the Index Ratio or the inflation-adjusted principal amount for the settlement date, the confirmation should reflect a Substitute Index Number (defined below) or the inflation-adjusted principal amount as of the settlement date calculated with the Substitute Index Number. The Substitute Index Number shall be calculated using the following formula (this formula will also be used by Treasury in the event a CPI number is not reported by the last day of the following month): (See Federal Register, Vol. 61, No. 189, September 27, 1996, page 50934)

Whenever a Substitute Index Number is disclosed on a confirmation or is used for the calculation of the inflation-adjusted principal amount, the party to the transaction shall disclose to its counterparty that the confirmation is subject to being reconfirmed when the actual CPI number(s) is/are available.

(iii) Within one business day of publication by the Bureau of Labor Statistics, U.S. Department of Labor, or the Treasury Department, as the case may be, of the applicable CPI number(s) to be used for calculation of the Index Ratio for the settlement date of the forward trade, each party to the transaction shall reconfirm the transaction in the manner described in paragraph 4(b)(i) above. Such reconfirmation shall specify the actual Index Ratio or the actual inflation-adjusted principal amount of the security as of the settlement date. Such confirmation shall supersede the previous confirmation. However, if the applicable CPI-U for the month of the settlement date is reported late and the Treasury Department provides an index number based on the last twelve-month change in the CPI-U available, the parties will not have to reconfirm the trade if the index number provided by Treasury is the same as the Substitute Index Number used on the original confirmation.

C. Definitions

1. **Index Ratio:** means, for any particular date and any particular Inflation-Indexed Security, the Reference CPI applicable to such date divided by the Reference CPI applicable to the original issue date (or dated date, when the dated date is different from the original issue date).
2. **Reference CPI:** means, the CPI-U applicable to a given date in accordance with the terms and conditions of Department of the Treasury, Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (as amended through December 1996). (See Proposed Amendment to Offering Circular in Federal Register, Vol. 61, No. 189, September 27, 1996, page 50924)
3. **Real Yield:** means, for Inflation-Indexed Securities, the yield based on the payment stream in constant dollars, i.e., before adjustment for inflation.
4. **Substitute Index Number:** means, for purposes of these Guidelines only, the index number that will be used on a confirmation or for calculating the inflation-adjusted principal amount as of the settlement date on a confirmation for a forward transaction in Inflation-Indexed Securities when the CPI number for the settlement date of the transaction is not available. In such a circumstance, the index number that is used shall be calculated using the formula provided in these guidelines. (The Substitute Index Number as herein defined is not to be confused with any index number that may be published by Treasury in the event a CPI number is not reported by the last day of the following month.)

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