

MEMO# 7898

May 28, 1996

TREASURY PROPOSAL ON INFLATION-PROTECTION SECURITIES

May 28, 1996 TO: INSTITUTIONAL FUNDS COMMITTEE No. 8-96 MONEY MARKET FUNDS AD HOC COMMITTEE No. 7-96 RE: TREASURY PROPOSAL ON INFLATION-PROTECTION SECURITIES

The Department of the Treasury recently published a notice of proposed rulemaking to solicit comments on the design details, terms and conditions and other features of a new type of Treasury security: "inflation-protection" securities. The Treasury Department has also published "Questions and Answers" and a notice of public meetings on the proposed securities. Copies of these documents are attached. The Treasury Department intends to issue inflation-protection securities in order to save on interest costs and broaden the types of debt instruments available to U.S. investors. The design of the inflation-protection securities currently being considered by Treasury is modeled, with some modifications, on the Real Return Bonds currently issued by the Government of Canada. Under the Canadian structure, the principal amount of an inflation-protection security is adjusted for inflation. Interest is paid semiannually, and interest payments are a fixed percentage of the value of the inflation-adjusted principal, in current dollars, for the date on which it is paid. Comment is requested on two alternative structures. The first alternative is a zero-coupon inflation-protection security. The Treasury only would make one payment on this type of security, which would be at maturity. In the second alternative, the Treasury would make periodic payments of principal and interest, similar to payments on a mortgage. Each payment would have the same value when adjusted for inflation, though the proportions of each payment representing principal and interest would change. Treasury is currently contemplating issuing either 10-year inflation-protection notes or 30-year inflation-protection bonds. The securities would be auctioned on a regular quarterly schedule, both with competitive and noncompetitive bidding. With respect to the inflation index on which to base the new securities, the Treasury is contemplating using the Consumer Price Index, and seeks comment on whether other indexes, such as the Employment Cost Index or the GDP deflator, would be more appropriate. Comment is also specifically requested on the appropriate size of the offerings. The Treasury also invites comments, by June 19, 1996, on any other issues relevant to the proposed securities. If there are any comments that you would like the Institute to address in a possible comment letter, please contact the undersigned at 202/326-5923 by Friday, June 7, 1996. Alexander C. Gavis Assistant Counsel

Attachments

should not be considered a substitute for, legal advice.