



MEMORANDUM

To: Members of the Federal Open Market Committee (and Federal Reserve Bank Presidents Not Currently Serving on the Committee)

From: Robert G. Rouse, Manager, System Open Market Account

Subject: Dealer Interviews Concerning
"Swaps" for the System Account

As suggested at the meeting of the Federal Open Market Committee on August 7, I have contacted representative dealer firms to discuss with them, on a purely exploratory and confidential basis, the possibility of making "swaps" in Treasury bills for the System Open Market Account. I have had discussions with Robert Morris, Vice President, Bankers Trust Company; C. J. Devine, Senior Partner of C. J. Devine and Company; Herbert N. Repp, President, Discount Corporation; and Emil J. Pattberg, Chairman of the Executive Committee, First Boston Corporation. As circumstances developed, my conversations with Mr. Morris and Mr. Devine occurred between each of them and me individually. Mr. Repp and Mr. Pattberg called separately by invitation and I asked Mr. Hayes and Mr. Roosa to participate.

All four dealers reacted very favorably to the suggestion. Each pointed out that "swapping" among maturities of Treasury bills is a frequent occurrence on the part of most large investors who maintain holdings of Treasury bills. Each volunteered the judgment that an extension of this technique to the System Account would provide material assistance in facilitating the day-to-day functioning of the Treasury bill market.

In the course of each conversation, I pointed out that the execution of swaps for the System would arise out of the needs related to the practical administration of the Account itself, and that there would be no presumption that the

System Account would be making swaps frequently, or making them merely for the purpose of assisting dealers in their efforts to broaden trading activity in the Treasury bill market. I also made it clear that any decisions by the Federal Open Market Committee on this matter would be followed by notification to all dealers, so that each would then be placed on an equal footing. Each of the dealers recognized the appropriateness of these various qualifications, and said that they would suspect that the dealers as a group would be so pleased to have this possibility opened up to them that the Trading Desk would undoubtedly receive many more proposals for swaps, originating at the initiative of the dealers, than the Trading Desk itself might find necessary or desirable in the System's interest.

The dealers specifically commented that they could see no likelihood of disturbance to the functioning of the market if the System Account were to approach dealers on its own initiative to propose possible swaps, but all of them thought that the need for the System Account to take such initiative would arise only very occasionally. They stressed that their own firms are ordinarily in search of possible swaps in some volume on almost every day, and indicated that they would expect to "show the System" any swaps in contemplation as a matter of course, once the doors were opened here to the consideration of possible swaps.

When we asked whether there was a possibility that any one dealer might, at any particular time, gain an unfair advantage over others by virtue of having effected a swap with the System Account, the dealers commented that they failed to see how that could be possible. We mentioned that we would, as we do in the case of all other transactions, make a careful check to assure that the prices obtained by the System Account on any swap transactions would be competitive. They said that they would expect such to be the case, and one ventured the opinion that our practices in this respect concerning outright transactions might even be considered unduly scrupulous, since there was always the risk that a widespread

checking of prices by the "Fed" might lead to some immediate price adjustments in the market "against the Fed". He recognized, however, the need for us always to maintain a record of competitive testing of all prices paid or received on securities transactions. The dealers also pointed out that the fact of open access to the Trading Desk, in order to present swapping possibilities, should remove any risk that one dealer could feel that he was discriminated against if he had not come into the Trading Desk with a possible swap, at a time when someone else was completing a similar swap with the Desk.

In general, our conclusion from these conversations was that the dealers were, if anything, unduly optimistic over the help that would be given to the performance of the market by opening up the possibility of swaps in Treasury bills with the System Account. While we did caution them that there would probably not be so many swaps as to have the substantial benefits they might envisage, we were encouraged to find that none of these dealers raised any critical question concerning the desirability or appropriateness of effecting swaps out of the System Account.