



CONFIDENTIAL (FR)

February 17, 1965

TO: Members of the Federal Open Market Committee and Reserve Bank Presidents not currently serving on the Committee

SUBJECT: Maturity Limitation on Repurchase Agreements During Treasury Refundings

FROM: R. W. Stone

This memorandum is addressed to a problem that has arisen during certain Treasury financing operations--particularly during advance refundings--when the effective use of repurchase agreements by the Trading Desk has been limited by the two-year maturity ceiling on Government securities that may be held under repurchase agreements.

The dealers typically play a very helpful role in Treasury exchange operations. They acquire supplies of "rights" from holders who do not wish to make the exchange and, against such acquisitions, make sales, on a "when-issued" basis, of the new securities being offered by the Treasury. In effect, therefore, the dealers facilitate, in a major way, the redistribution of rights from those investors who do not wish to acquire the new securities to those who do. The dealers also use their acquisitions of rights to establish an underwriting position in the new issues, which they hope to distribute to investors in response to demand that unfolds in the weeks following the Treasury operation. The dealers must of course find financing for their holdings of rights. To a considerable extent, as the dealers acquire rights they sell Treasury bills or other short-term Government securities to the investors who have sold the rights, so that during many financing

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operations the dealers' positions tend to be relatively heavy in rights and relatively light in bills and other short-term issues.

The Desk frequently finds it necessary to supply reserves during Treasury financing operations in order to maintain the "even keel" position customarily adopted by the Committee at such times. Repurchase agreements are often the most suitable vehicle for supplying such reserves. However, as noted above, it often happens that during financing operations dealers have relatively light holdings of short-term securities other than rights to use in arranging repurchase agreements with the System. The dealers' heaviest financing need is to carry rights, but under the existing two-year maturity limit on securities held against repurchase agreements, the System cannot hold, beyond the date when the subscription books close, any rights that dealers have committed to exchange for new securities of longer than two years to maturity.^{1/} We have therefore found it necessary on several occasions to terminate repurchase agreements against rights the day after the subscription books close, even though the settlement date for the financing concerned was a week or ten days in the future. It has been necessary to do this in virtually every advance refunding, since the issues being offered in such operations are typically of

^{1/} It has long been our practice to consider that when a dealer enters a subscription to exchange a right for another security being offered by the Treasury, he has undertaken an irrevocable commitment to acquire the new security; and if that new security is of more than two years to maturity, we have felt that we are not authorized to hold the right after the subscription has been entered. (Dealers generally wait until the close of business on the final day the books are open before submitting their subscriptions.)

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more than two years to maturity. The termination of repurchase agreements in the middle of financing operations because of the two-year limit has at times been quite burdensome to the market and inconvenient to the System.

I think it would be desirable to relieve the problem described above so that the usefulness of the repurchase agreement technique in supplying reserves might be enhanced and the Committee's aims thereby promoted. The simplest step, and the one I would recommend, would be to remove the maturity limitation on the securities held under repurchase agreements altogether.^{1/} Undoubtedly, the preponderant portion of agreements would continue to be against bills and other short-term issues, just as is the case with outright System purchases and sales, since it is in the short area that dealer positions are generally heaviest. If the two-year limit were removed, the Account Management would have flexibility to go beyond the short area in accepting collateral for repurchase agreements as necessary to accomplish the Committee's objectives.

A more limited step would be to remove the maturity limitation on securities held under repurchase agreements around the time of Treasury refunding operations--say from the day after the Treasury announces its refunding until the settlement date for the exchange. This would modify the limitation at those times that it has had its main restrictive effect.

^{1/} This could be done by amending Section 1 (c) of the continuing authority directive to delete the words "with maturities of 24 months or less at the time of purchase" from the first clause. The beginning of this Section would then read: "To buy U.S. Government securities, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers"

of any maturity,