



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

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STRICTLY CONFIDENTIAL (FR)
CLASS I FOMC

TO: Federal Open Market Committee SUBJECT: Subcommittee recommendations
for revised foreign currency
FROM: Arthur L. Broida *ALB* instruments

In a report distributed on November 12, 1976, the Subcommittee on Foreign Currency Instruments proposed broad revisions in the Committee's Authorization for Foreign Currency Operations and Foreign Currency Directive as well as the adoption of a third instrument, called "Procedural Instructions." Mainly on the basis of comments and suggestions received from Committee members and staff, the Subcommittee now proposes certain modifications in the language it recommended earlier for the three instruments.

These modifications, together with a brief explanation of each, are shown in Attachment A. The complete text now proposed for the three instruments is shown in Attachments B, C, and D.

As will be noted, the main modification suggested in the Authorization relates to the manner of expressing the limit on the System's overall "open position" in foreign currencies. The main modifications suggested in the Procedural Instructions are (1) to call for clearance by the Subcommittee of transactions not only when the overall

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open position would be changed by a specified amount but also when gross transactions in a single foreign currency would exceed a specified amount, and (2) to call for clearance by the Subcommittee or Committee of all swap drawings proposed by foreign central banks, not just those that exceed a specified amount. Only one small change, of a stylistic nature, is suggested in the proposed new language for the Foreign Currency Directive.

Attachments

ATTACHMENT A

Proposed Amendments to Draft Foreign Currency Instruments

I. Authorization for Foreign Currency Operations

¶ 1.

TO MAINTAIN AN

D. ~~The System's~~ overall open position in all foreign currencies
ING \$1.0 A LARGER POSITION IS

~~shall~~ not exceed/~~\$2.1~~ billion, unless/expressly authorized by
THIS

the Committee. For ~~these~~ purposes, ~~an open position in a single~~

~~foreign currency is defined as holdings of balances in that~~

~~currency, plus outstanding contracts for future receipt less~~

~~outstanding contracts for future delivery of that currency.~~ The

overall open position in all foreign currencies is defined as the
(DISREGARDING SIGNS)

sum/of open positions ~~(disregarding signs)~~ in each currency.

THE OPEN POSITION IN A SINGLE FOREIGN CURRENCY IS DEFINED AS

HOLDINGS OF BALANCES IN THAT CURRENCY, PLUS OUTSTANDING CONTRACTS

FOR FUTURE RECEIPT, MINUS OUTSTANDING CONTRACTS FOR FUTURE DELIVERY

OF THAT CURRENCY, I.E., AS THE SUM OF THESE ELEMENTS WITH DUE

REGARD TO SIGN.

Reason for change: Mainly syntax and clarity. The substantive

change is to reduce the figure for the overall open position to

that originally intended by the Subcommittee as the effective

limit on new position taking. The present short position of nearly

\$1.1 billion in Swiss francs, arising from the System's 1971 swap

drawings, would be handled separately by means of an express

authorization of the Committee, to be adopted simultaneously

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with the new Authorization.^{1/} The advantage of this is that the Authorization limit would not have to be continually revised downward as we repay the Swiss swaps over the next three years. The \$1.0 billion figure in the amended language will give the public a more accurate notion of the intention of the Committee with regard to future policy.

¶ 3.

... Apart from any such purchases at the rate of the drawing, all transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates.~~and no attempt shall be made to establish rates that appear to be out of line with underlying market forces.~~

Reason for change: Paragraph is a technical one detailing the rates at which the System may transact -- market rates or, in the case of purchase from central banks for repayment of swap drawings, at the drawing rate. The omitted language appears to give policy guidance, which is the function of the Directive.

II. Foreign Currency Directive

¶ 4.

IN A MANNER
C./ consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the proposed IMF Article IV.

^{1/} Suggested language for the proposed express authorization is shown in Attachment E.

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Reason for change: Syntax.

III. Procedural Instructions

Introduction

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations/^{AND THE FOREIGN CURRENCY DIRECTIVE}the Federal Reserve Bank of New York, through the Manager of the System Open Market Account, ~~is~~ SHALL BE guided by the following procedural understandings with respect to consultation and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. ALL OPERATIONS UNDERTAKEN PURSUANT TO SUCH CLEARANCES SHALL BE REPORTED PROMPTLY TO THE COMMITTEE.

Reason for change: Style and simplification. The instruction regarding prompt reporting to the Committee was previously included in both paragraphs 2. and 4. To avoid this repetition, the instruction is moved to the introductory paragraph.

¶ 1.

1. The Manager shall clear with the Subcommittee (OR WITH THE CHAIRMAN, IF THE CHAIRMAN BELIEVES THAT CONSULTATION WITH THE SUBCOMMITTEE IS NOT FEASIBLE IN THE TIME AVAILABLE):

Reason for change: Moved from ¶ 2. for the sake of clarity and form.

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TRANSACTION WHICH

A. Any/~~further-increase-(decrease)-in-the-System's-overall~~
~~open-position-in-foreign-currencies,-if-such-increase-(decrease)~~
IN FOREIGN CURRENCIES
would result in a change in the SYSTEM'S overall open position/
exceeding \$100 million on any day or \$300 million since the
REGULAR
most recent/meeting of the Committee.

Reason for change: Mainly stylistic. The word "regular" was
added to remove any ambiguity about the "most recent meeting"
in the event that there were interim telephone conference
meetings of the Committee.

B. ANY TRANSACTION WHICH WOULD RESULT IN GROSS TRANSACTIONS
(EXCLUDING SWAP DRAWINGS AND REPAYMENTS) IN A SINGLE FOREIGN
CURRENCY EXCEEDING \$150 MILLION ON ANY DAY OR \$450 MILLION SINCE
THE MOST RECENT REGULAR MEETING OF THE COMMITTEE.

Reason for change: This addition enhances the Committee's sur-
veillance of the Manager's activities by providing "trigger
points" in the form of limits on gross transactions, supple-
menting the limits in terms of the overall open position
specified in A. above.

C. ANY

B. A swap drawing proposed by a foreign bank ~~if-the-drawing~~
~~would-result-in-an-increase-in-that-bank's-indebtedness-to-the~~
NOT
System-since-the-most-recent-meeting-of-the-Committee/exceeding
\$200
the larger of (i) ~~\$150~~ million or (ii) 15 per cent of the size
of the swap arrangement.

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Reason for change: Formerly B. Tightens surveillance, in conjunction with new ¶ 2.B., by having manager clear all swap drawings with either the Committee or the Subcommittee. The new figure, \$200 million, which could be authorized by the Subcommittee alone, is less than the full amount of the smallest swap arrangement (\$250 million).

~~2.--The Manager shall clear such operations with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available.--All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.~~

2.

3. The Manager shall clear with the Committee (OR WITH THE SUBCOMMITTEE, IF THE SUBCOMMITTEE BELIEVES THAT CONSULTATION WITH THE FULL COMMITTEE IS NOT FEASIBLE IN THE TIME AVAILABLE, OR WITH THE CHAIRMAN, IF THE CHAIRMAN BELIEVES THAT CONSULTATION WITH THE SUBCOMMITTEE IS NOT FEASIBLE IN THE TIME AVAILABLE):

Reason for change: Form and clarity.

TRANSACTION WHICH

A. Any/~~further-increase-(decrease)-in-the-System's-overall-open position-in-foreign-currencies,-if-such-increase-(decrease)~~ would
IN FOREIGN CURRENCIES
result in a change in the SYSTEM'S overall open position/exceeding
REGULAR
\$500 million since the most recent/meeting of the Committee.

Reason for change: Syntax and clarity.

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ANY
EXCEEDING THE
B. A swap drawing proposed by a foreign bank/~~if the drawing~~
LARGER OF (i) \$200 MILLION OR (ii) 15 PER CENT OF THE SIZE
~~would result in an increase in that bank's indebtedness to the~~
OF THE SWAP ARRANGEMENT.
~~System of more than \$500 million since the most recent meeting~~
~~of the Committee.~~

Reason for change: Together with new ¶ 1.C., provides for
Committee or Subcommittee clearance of all swap drawings by
foreign central banks.

~~4. The Manager shall clear such operations with the Subcommittee,~~
~~if the Subcommittee believes that consultation with the full~~
~~Committee is not feasible, in the time available, or with the~~
~~Chairman, if the Chairman believes that consultation with the~~
~~Subcommittee is not feasible in the time available. All operations~~
~~undertaken pursuant to such clearances shall be reported promptly~~
~~to the Committee.~~

Reason for change: Form and clarity. Covered by new ¶ 2.

3.

5. The Manager shall also consult with the Subcommittee or the
 INCLUDING PROPOSED SWAP DRAWINGS BY THE SYSTEM,
Chairman about other transactions, /when the amounts are substantial

and OR the operations are not of a routine character.

Reason for change: Enhances Committee surveillance.