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

September 28, 1981

STRICTLY CONFIDENTIAL (FR)
CLASS I - FOMC

TO: Federal Open Market Committee

FROM: Murray Altmann M. A.

Attached for your information is a memorandum to the Board of Governors from Messrs. Adams and Truman of the Division of International Finance and Mr. Schwartz of the Legal Division, dated September 28, 1981, describing special investment facilities at the New York Reserve Bank that will be provided to the International Monetary Fund by authorization of the Board. Any questions about this subject may be addressed to Mr. James H. Oltman at the Federal Reserve Bank of New York, or to Mr. Schwartz at the Board.

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date September 28, 1981

To Board of Governors

From Messrs. Adams and Truman
(Division of Int'l Finance)
Mr. Schwartz
(Legal Division)

Subject: SDR-denominated deposit facilities for the IMF at the New York Bank.

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The International Monetary Fund earlier this year inquired whether the Federal Reserve would provide an SDR-denominated investment account at the New York Bank in which the IMF could deposit funds that were temporarily in excess of disbursement needs. The excess balances will arise in connection with the Fund's plans to finance members' enlarged access to its resources by borrowing from certain OPEC and other official sources. In the first year, amounts up to SDR 500 million (about $600 million) might be held at any one time.

The Board on April 8 agreed in principle that it would be in the interests of the U.S. Government and the Federal Reserve System for such an account to be opened. By providing the account, the Federal Reserve would assist the IMF in maintaining the SDR value of its assets and demonstrate the continuing support of the United States for the IMF. The Treasury Department supported the Fund's request. Attached is the Board's letter to President Solomon regarding the account.

The Board's action was based, in part, on the understanding that because of the Fund's unique status, the account would not set an undesirable precedent in regard to paying interest on deposits or offering accounts denominated in other than dollars. In addition, the Bank's risks in operating the account would be narrowly limited, while the IMF would obtain a substantial benefit from its use. The account is expected to be the primary

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(though not necessarily exclusive) means used by the IMF to manage the excess balances. These last two features differentiate the current proposal from a similar IMF request that was turned down by the Board in 1979.

Negotiations over a formal agreement governing the account are substantially completed along the lines envisaged at the time of the Board's approval on April 8, and the initial deposit is expected to be made sometime in October.

In operating the account, the New York Bank will act, as a strictly legal matter, as principal rather than as agent for the Fund. It will receive a sum of U.S. dollars from the Fund, value said amount in terms of SDR, and undertake to repay the deposit at maturity with interest. The Bank will use its best efforts to obtain the rate of interest indicated to the Fund at the time a deposit is made. The U.S. dollar amount of the repayment would be adjusted for changes in the SDR value of the dollar during the term of the deposit. To cover exchange risks, and to establish the return on the non-dollar portion of the SDR deposit, the Bank, for its own account, will purchase forward, and subsequently sell spot or forward, in the foreign-exchange markets, appropriate amounts of the non-dollar component currencies of the SDR -- the mark, the yen, the French franc, and sterling.

The New York Bank for its own account will invest the dollars received from the IMF in U.S. Government and Federally sponsored agency securities, and in repurchase agreements collateralized by such securities. These investments will be made through purchases in the market or from the System Open Market Account. (RP investments may be made through the Bank's foreign account RP pool.) The proceeds from these investments, adjusted for the results of foreign exchange cover operations and transaction costs, will serve as the basis for calculating the interest to be paid on the Fund's deposits. However, a fraction of the proceeds from each U.S. dollar investment may be set aside and used when necessary to maintain in terms of SDR the value of the principal of the Fund's deposits. This procedure, which was not contemplated when the Board considered the IMF's proposal in April, will serve to guard against impairment of the value of a deposit in SDR terms as a consequence of transactions related to the technical operation of the account. Such potential impairments are in any case expected to be rare. Funds not used for this purpose will be paid over to the IMF in the future. In certain circumstances, this feature of the arrangement could conceivably lead to the Bank's experiencing a net loss at the termination of the IMF account. The Bank has designed operational procedures, however, that make realization of such a loss highly unlikely.

Although technically acting as principal, the Bank, under the arrangements formulated with the IMF, will act in a manner functionally equivalent to the role it plays in investing funds as agent on behalf of its foreign and international correspondents. The effect of these transactions will be to provide the Fund with investment facilities that will protect the SDR value of its assets and yield an SDR-related rate of return. While the Bank will bear certain risks, they will be minimized by the Bank's operational procedures and, we believe, adequately compensated by the IMF.

Attachment

April 14, 1981

Mr. Anthony M. Solomon, President
Federal Reserve Bank of New York
New York, New York 10045

Dear Mr. Solomon:

The Board of Governors has considered the International Monetary Fund's proposal that an account at the Federal Reserve Bank of New York be opened for IMF use in connection with its current borrowing program. Under the proposal, as set forth in your letter of April 2, 1981, transactions involving the account would entail dollar deposits and certain foreign exchange transactions which would have the effect of providing the IMF with SDR-denominated investment facilities.

The Board agrees in principle that it would be in the interests of the U.S. government and the Federal Reserve System for such an account to be opened, since by providing the requested facilities, the Federal Reserve would assist the IMF in maintaining the SDR value of its assets and demonstrate the continuing support of the United States for the IMF. The Treasury Department supports the proposal.

Accordingly, the Board authorizes the Federal Reserve Bank of New York to undertake discussions with the IMF with the objective of securing an agreement governing the operation of such an account in a manner similar to that described in your letter.

Sincerely,

(Signed)

D. Michael Manies
Assistant Secretary

bcc: Messrs. Schwartz, Truman, Adams, McAfee, Ms. Winebarger, Ms. Brown

DEA:FMT:clc