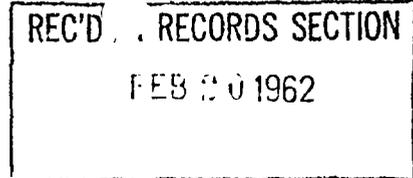




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



February 19, 1962.

TO: Federal Open Market Committee

FROM: Mr. Sherman

For your information, there is attached a copy of a statement of the legal authority for Federal Reserve foreign exchange operations prepared by Howard H. Hackley, General Counsel of the Committee, and furnished, upon request, to the Joint Economic Committee. Copies also have been sent to the Chairmen of the Banking and Currency Committees of the Senate and House for their information.

A handwritten signature in cursive script, appearing to read "Merritt Sherman", written in black ink.

Merritt Sherman, Assistant Secretary,
Federal Open Market Committee.

Enclosure

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LEGAL AUTHORITY FOR FEDERAL RESERVE FOREIGN EXCHANGE OPERATIONS

It is understood that the Executive Director of the staff of the Joint Economic Committee has orally requested a brief statement regarding the legal authority of the Federal Reserve System to engage in foreign currency operations or, as they are sometimes called, foreign exchange operations.

The first paragraph of section 14 of the Federal Reserve Act (12 U.S.C. 353) authorizes any Federal Reserve Bank to "purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange. . . ." The term "cable transfers" itself suggests dealings in foreign exchange, since cable transfers are, of course, a medium through which the Reserve Banks may acquire or dispose of holdings of foreign currency in the form of balances with foreign banks.

Section 14(a) of the Federal Reserve Act (12 U.S.C. 354) authorizes the Federal Reserve Banks to deal in gold at home or abroad and to make loans on gold.

Section 14(e) of the Act (12 U.S.C. 358) authorizes any Federal Reserve Bank, with the consent or upon the order and direction of the Board of Governors and under regulations prescribed by the Board, to open and maintain accounts in foreign countries, and to appoint correspondents and establish agencies in such countries, and, through such foreign correspondents or agencies, to buy and sell bills of exchange and acceptances. Whenever an account in a foreign country is opened by a Federal Reserve Bank, any other Federal Reserve Bank may, with the consent and approval of the Board, be permitted to carry on, through the Reserve Bank opening such account, any of the transactions authorized by section 14 of the Act.

All of these provisions were contained in substantially their present form in section 14 of the original Federal Reserve Act. The Report of the House Banking and Currency Committee with respect to the original Act stated that one of the objectives of the provisions of section 14 was to provide an outlet through which funds of the Federal Reserve Banks might be used in order "to facilitate transactions in foreign exchange or to regulate gold movements."

Holdings of foreign currency by the Federal Reserve Banks in the form of accounts with foreign banks may arise through open market purchases of cable transfers and bills of exchange, through sales of gold to foreign banks, and through the establishment of cross-credits or reciprocal balances between a Federal Reserve Bank and a foreign bank.

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To the extent that such transactions involve open market purchases and sales, they are subject to direction and regulation by the Federal Open Market Committee under the provisions of section 12A of the Federal Reserve Act (12 U.S.C. 263) which provides that "no Federal Reserve Bank shall engage or decline to engage in open market operations under section 14 of the Act except in accordance with the direction of and regulations adopted by the Committee." Insofar as such transactions involve the opening and maintenance of accounts with foreign banks, they are subject also to the consent and regulations of the Board of Governors of the Federal Reserve System.

There is, of course, no provision of present law that specifically refers to foreign currency or foreign exchange operations by the Federal Reserve System; and, accordingly, it cannot be said that there is explicit and clear authority for such operations. However, in view of the provisions of law above mentioned, and without attempting here to recite all of the reasons that lead to such conclusion, it is my opinion that the Federal Reserve Banks are authorized by present law to engage in open market transactions in foreign exchange subject to direction and regulation of the Federal Open Market Committee and, for this purpose, to open and maintain accounts in foreign banks subject to the consent and under regulations of the Board of Governors of the Federal Reserve System.

In the course of consultations between the Board of Governors and the Treasury Department regarding this matter, the Treasury Department advised the Board that the above-stated opinion has been concurred in by the General Counsel for the Treasury Department and by the Attorney General of the United States.

Howard H. Hackley, General Counsel,
Federal Open Market Committee.

HHH:jc
2-19-62