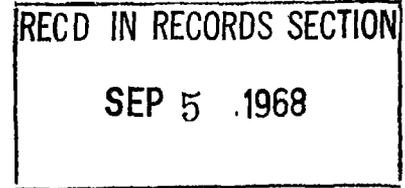




BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551



CONFIDENTIAL (FR)

September 4, 1968

To: Federal Open Market Committee

From: Mr. Holland

Enclosed is a memorandum from the Account Manager dated today and entitled "System Lending of U.S. Government Securities." It is expected that this memorandum, together with its two attachments, will be considered at the September 10 meeting of the Committee in connection with item 8 of the agenda.

A handwritten signature in cursive script, appearing to read "Robert C. Holland".

Robert C. Holland, Secretary  
Federal Open Market Committee.

Enclosure

SEP 5 1968

September 4, 1968

To: Federal Open Market Committee                      Subject: System Lending of U.S. Government Securities.

From: Alan R. Holmes  
Manager  
System Open Market Account

At its meeting on August 13, 1968, the Committee held a preliminary discussion of my memorandum of August 6, setting forth proposed terms and conditions for lending U.S. Government securities held in the System Open Market Account. As a result of subsequent staff discussions the proposed terms and conditions have been reformulated as shown in Attachment A.

Most of the modifications are of a clarifying nature, but one involves a substantive change in the accounting procedures to be followed. As before, it is proposed that no entries reflecting loans of securities be made on the System Account books other than a notation that the particular securities have been loaned. It is now proposed, however, that such transactions be treated as loans of securities solely from the unpledged portion of the participation of the Federal Reserve Bank of New York in the System Account, and that notation of any securities loaned be made on the statements of condition of the New York Bank and on consolidated System statements of condition. A summary of the proposed accounting treatment is given in Attachment B but is not intended as part of the formal terms and conditions proposed in Attachment A.

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This treatment would permit much simpler accounting procedures than would be involved if (a) the participations of all twelve Reserve Banks were affected and/or (b) the securities loaned were removed from the System Account books. It should also minimize the potential problem of insufficient securities in the participations of some Reserve Banks, beyond those required as collateral for Federal Reserve notes, for purposes of lending. And, of course, the letters of authorization from the other Reserve Banks, proposed in the previous memorandum, would not be required.

In my previous memorandum I recommended that the continuing authority directive be amended to authorize lending of securities from the System Account, and in a memorandum dated August 7, 1968, the FOMC Secretariat proposed specific language for the directive for consideration by the Committee if it approved my recommendation. For convenience that language, which would constitute a new paragraph at the end of the present directive, is quoted below:

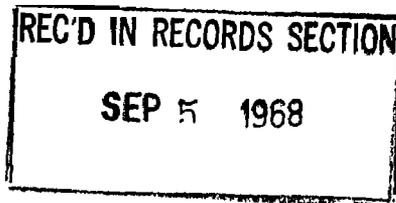
"The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, on such terms and conditions as are established by the Committee from time to time."

In summary, I recommend (1) that the Committee amend the continuing authority directive by the addition of this paragraph, and (2) that it adopt the "terms and conditions" set forth in

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Attachment A pursuant to the final clause of the paragraph. If these recommendations are approved we would still plan to hold discussions with interested dealers and banks, and as an outgrowth of those discussions we might want to propose changes in the terms and conditions before any operations under the new authority were undertaken.

Attachments.



ATTACHMENT A

TERMS AND CONDITIONS FOR LENDING SECURITIES  
FROM SYSTEM OPEN MARKET ACCOUNT

Loans of Securities from System  
Open Market Account

United States Government securities held in the System Open Market Account, in an amount not exceeding at any one time the Federal Reserve Bank of New York's unpledged participation in that Account, may be loaned by Federal Reserve Bank of New York in accordance with the terms and conditions set forth below (I) to Government securities dealers with whom Federal Reserve Bank of New York does business for the System Account who are unable to deliver securities which they have contracted to sell, and (II) to banks participating in Government securities clearing arrangements in which a Federal Reserve Bank participates that are unable to deliver at the end of a day securities owing to a Federal Reserve Bank under the terms of the clearing arrangement.

I Loans to Government Securities Dealers  
in Connection with Delivery Failures

1. The borrower will be required to certify that he is borrowing the securities to fulfill a contract to deliver the securities, that the securities are not to be used in connection with a short sale, and that he cannot borrow the securities elsewhere.

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2. Securities may be loaned for periods not to exceed three business days. Loan contracts may be renewed only when, in the judgment of Federal Reserve Bank of New York, circumstances exist which justify a renewal. Any renewals will be subject to the same terms and conditions as the original contracts.
3. Securities may be loaned up to the following limits:
  - a. Treasury bills--up to \$50 million total par value to any one dealer in one transaction.
  - b. Coupon issues--up to \$10 million total par value to any one dealer in one transaction.
  - c. Total outstanding to any one dealer at any one time not to exceed \$75 million par value.
4. The borrower will be required to pledge collateral consisting of U.S. Government securities of greater current market value than the securities borrowed, and the collateral may be acquired by the System Open Market Account or sold in the market in the event the borrower does not make timely return of the borrowed securities in accordance with the provisions of the contract.
5. The borrower will be charged interest on the principal amount (par value) of the securities borrowed at the rate of 5/8 per cent per annum per day until the timely return of the securities.

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6. If the securities are not returned on time, the borrower will be charged interest on the principal amount of securities borrowed at the rate of 6 per cent per annum per day (including the day the securities should have been returned) until the securities are returned or the collateral sold.

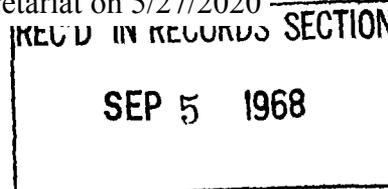
II Loans to Participants in Securities Clearing Arrangements in which a Federal Reserve Bank Participates

1. The Fiscal Agency function of the Federal Reserve Bank conducting the arrangement will certify to the Securities Department of the Federal Reserve Bank of New York that one of the banks participating in the arrangement is unable to deliver certain Government securities needed to settle the clearing.
2. Securities may be loaned for not more than one business day and must be returned the following business day. Loan contracts may be renewed only when, in the judgment of Federal Reserve Bank of New York, circumstances exist which justify a renewal. Any renewals will be subject to the same terms and conditions as the original contracts.

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3. The amounts of securities to be loaned will be subject to no fixed limits but will be determined by Federal Reserve Bank of New York in the exercise of its best judgment.
4. The borrower will be required to pledge collateral consisting of U.S. Government securities of greater current market value than the securities borrowed and the collateral may be acquired by the System Open Market Account or sold in the market in the event the borrower does not make timely return of the borrowed securities in accordance with the provisions of the contract.
5. The borrower will be charged interest on the principal amount of the securities borrowed at the rate of  $5/8$  per cent per annum per day until the timely return of the securities.
6. If the securities are not returned on time, the borrower will be charged interest on the principal amount of the securities borrowed at the rate of 6 per cent per annum per day (including the day the securities should have been returned) until the securities are returned or the collateral sold.

September 4, 1968



ATTACHMENT B

ACCOUNTING TREATMENT OF SECURITIES LOANED  
FROM SYSTEM OPEN MARKET ACCOUNT

1. Details of securities loaned will be recorded in a separate subsidiary memorandum ledger to be maintained by the Securities Department of the Federal Reserve Bank of New York as a part of the System Account records. Otherwise, such securities would not be segregated on the System Account books from other securities.
2. Contracts covering securities loaned will be recorded in detail in a ledger to be maintained by the Securities Department of the Federal Reserve Bank of New York, including the collateral held to secure the contracts.
3. Securities loaned will be considered as part of the unpledged portion of the participation of the Federal Reserve Bank of New York in the System Account. Statements on Form F.R. 34 and published statements of the Federal Reserve Bank of New York will contain footnotes reporting the total principal amount of the security holdings of the Federal Reserve Bank of New York loaned, together with a statement to the effect that the loans are fully secured by U.S. Government securities pledged with the Bank. Consolidated published statements of the twelve Federal Reserve Banks will contain similar footnotes.

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4, The interest income from the loan contracts will be classified as miscellaneous income of the Federal Reserve Bank of New York; it will not be participated among the Federal Reserve Banks.

September 4, 1968