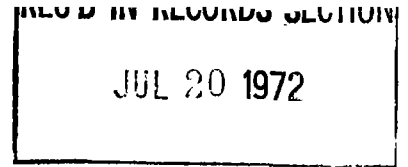


BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM



Office Correspondence

Date July 13, 1972

To Federal Open Market Committee

Subject: Proposed Revision of Procedures
for Allocation of Securities in System
Open Market Account

From John N. Kiley and
Alan R. Holmes

CONFIDENTIAL (FR)

Present procedures with respect to the allocation of securities in the System Open Market Account, adopted by the Federal Open Market Committee on March 21, 1968, call for a regular reallocation on the last business day of each month. No provision is made for interim reallocations during the month for any purpose. Prior to March 1968, the procedures (in effect since March 1965) had included a provision for a special reallocation of the Account whenever there was a deficiency in the gold reserve requirement of a Reserve Bank, but this provision was dropped in the 1968 revision in view of the termination of legal gold reserve requirements.

Since the new procedures were adopted, there have been several occasions over the last year and a half when abnormally large transactions in the Interdistrict Settlement Fund have reduced the gold certificate account of a Reserve Bank to an overdraft status. Until last week these deficiencies did not occur on a Reserve Bank statement date and were allowed to stand. The deficiencies were eliminated on the following days as the flows of funds reversed themselves. However, on Wednesday, July 5, a Reserve Bank incurred an overdraft which, if not corrected, would have been reflected as

To: Federal Open
Market Committee

-2-

July 13, 1972

a negative balance in its gold certificate account in the weekly statement. After consultation between the staffs of the Board of Governors and the New York Reserve Bank, the problem was dealt with by the purchase of securities by the New York Reserve Bank from the overdrawn bank as of Wednesday, July 5, to eliminate the deficiency and provide a small balance. The purchase was reversed on Friday, July 7, by which time the temporary distortion in the Reserve Bank's position had corrected itself. This limited reallocation of the Account was undertaken in the absence of specific authority to do so with the belief that under the unusual circumstances the Committee would approve the action.

In light of this experience, it is now recommended that the Procedures for Allocation of Securities in the System Open Market Account be amended to provide for interim reallocations to deal with temporary deficiencies in the gold certificate account. This could be accomplished by adding the following clause to the second paragraph of the procedures:

....except that temporary interim adjustments may be made in the apportionments for two or more banks when desirable in the judgment of the Director of the Board's Division of Federal Reserve Bank Operations and the Manager of the System Open Market Account.

Although this language would permit temporary adjustments for any purpose, it is contemplated that, unless otherwise requested, the staff would make adjustments only to correct temporary overdrafts

To: Federal Open
Market Committee

-3-

July 13, 1972

that occur on a Reserve Bank statement date, and that such adjustments would be reversed as soon thereafter as maybe convenient.

Attached is a copy of the procedures, including the suggested amendment.

Attachment

Proposed Revision of Procedures for
Allocation of Securities in System
Open Market Account

1. Securities in the System Open Market Account shall be reallocated on the last business day of each month by means of adjustments proportionate to the adjustments that would have been required to equalize approximately the average ratios of gold holdings to note liabilities of the 12 Federal Reserve Banks based on the ratios of gold to notes for the most recent five business days.

2. Until the next reallocation the Account shall be apportioned on the basis of the ratios determined in paragraph 1, EXCEPT THAT TEMPORARY INTERIM ADJUSTMENTS MAY BE MADE IN THE APPORTIONMENTS FOR TWO OR MORE BANKS WHEN DESIRABLE IN THE JUDGMENT OF THE DIRECTOR OF THE BOARD'S DIVISION OF FEDERAL RESERVE BANK OPERATIONS AND THE MANAGER OF THE SYSTEM OPEN MARKET ACCOUNT.

3. Profits and losses on the sale of securities from the Account shall be allocated on the day of delivery of the securities sold on the basis of each Bank's current holdings at the opening of business on that day.