



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20561

March 19, 1982

CONFIDENTIAL (FR)  
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Murray Altmann *M.A.*

Attached are memoranda relating to the review of System lending of securities, from the Manager for Domestic Operations dated March 11, and from the Committee's General Counsel dated March 19. These memoranda will be discussed at the forthcoming meeting of the Committee.

Attachments

March 11, 1982

TO: FEDERAL OPEN MARKET COMMITTEE                      Subject: Review of System  
Lending of Securities

FROM: Peter D. Sternlight *PDS*  
Manager for Domestic Operations  
System Open Market Account

Attached is a statistical report on the lending to dealers of Treasury securities held in the System Open Market Account since the last annual meeting of the Federal Open Market Committee in March 1981. As in the previous year, the data show a decrease in the number of loans made, while the average size of loans has again increased. Market delivery failures rose further in calendar year 1981 and the dealers did not return the borrowed securities as quickly as in the past, so the daily average volume of System loans outstanding rose by 45 percent to \$288 million.

The increase in the daily average dollar amount of System loans parallels the rise in the volume of trading activity which surpassed the previous year's record volume by almost 35 percent, reaching a daily average of about \$24.6 billion. The fact that the relative increase in daily average fails to deliver securities was less than half the increase in trading volume (14 percent compared with 33 percent) strongly suggests that dealers' use of the System's lending operation has enabled them to keep delivery failures from becoming worse.

In my opinion, the lending operation has provided support to the market and remains reasonably necessary for the efficient

conduct of System open market operations. I therefore recommend that the Committee renew the authorization to lend securities. While annual renewals present no serious problem, I would like at this time in the interest of greater efficiency in using the Committee's time, to recommend that this renewal place the authorization for lending on the same continuing basis as the other elements in the Authorization for Domestic Open Market Operations.

Over the years the Account Management has cited a number of reasons for continuing the lending operation--including increased trading volume in Government securities, scarcities of securities in the hands of traditional lenders and growing delivery delays due to computer problems both inside and outside the Federal Reserve System. At present I am hard pressed to see near-term relief from these factors. If the Committee should agree to a continuing authorization for lending, I can assure you that the Account Management would continue to monitor the operation closely and would be prepared to recommend discontinuing the operation if conditions made it no longer reasonably necessary for the effective conduct of System open market operations.

In the meantime, the operation has remained profitable. Earnings for the Federal Reserve Bank of New York in 1981 amounted to \$4,020,086, an increase of about 33 percent from 1980. Since the actual number of loans is down and with the increased automation of the operation, expenditures needed to run the lending operation are less than in the past, and are estimated at approximately 5 percent of earnings.

Attachment

STATISTICS ON FEDERAL RESERVE  
LENDING OF SECURITIES  
(dollars in millions)

	<u>March 1980 through Feb. 1981</u>	<u>March 1981 through Feb. 1982</u>	<u>Percentage Change</u>
Number of Loans	10,009	7,669	-23
Total Amount	\$25,198	\$33,618	+33

DAILY AVERAGES

Number of Loans	40	31	-23
Amount	\$101.6	\$135.6	+33
Balance Outstanding	\$198.7	\$288.2	+45
Size of Each Loan	\$ 2.5	\$ 4.4	+76

DEALER FAIL STATISTICS

	<u>1980</u>	<u>1981</u>	
Daily Average Fails to Receive	\$500	\$624	+25
Daily Average Fails to Deliver	\$404	\$459	+14

March 19, 1982

To: Federal Open Market Committee      Subject: Review of System Lending  
From: Mr. Bradfield       of Securities

In his memorandum of March 11, 1982 to the Committee, the Manager for Domestic Operations, System Open Market Account reviews the practice of lending to dealers of Treasury securities held in the System Open Market Account. The Manager states that while there has been a decrease in the number of loans made, the average size of loans has increased. This parallels the rise in the volume of trading activity. It is suggested that the System's lending operation has enabled dealers to keep delivery failures from becoming worse. The Manager indicates his view that the lending operation has provided support to the market and remains reasonably necessary for the efficient conduct of System open market operations. Further, he recommends that the Committee renew the authorization to lend securities to dealers.

Based upon the Manager's report, it is my opinion that the Committee could reasonably conclude that the continuation of lending securities is reasonably necessary to the efficient conduct of System open market operations and that the activity, therefore, is incidental to the carrying on the business of the Reserve Banks under § 4 of the Federal Reserve Act (12 U.S.C. § 341).

The Manager also indicates that the events that necessitate continuation of the System's lending securities will likely continue into the foreseeable future. He therefore recommends that, in the interest of efficiency, the authorization to lend securities be placed on a continuing basis rather than renewed annually. The Manager states that the lending

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operations would be monitored closely to assure that the operation is reasonably necessary for the effective conduct of open market operations. The record indicates that every year since 1969 the Committee has determined that the lending of securities is reasonably necessary for the effective conduct of open market operations. In view of the pattern established during the past twelve years and the Manager's commitment for monitoring of conditions by Account Management, it is my opinion that the Committee may authorize the operation on the same continuing basis as the other elements in the Authorization for Domestic Open Market Operations.