



CONFIDENTIAL (FR)

TO: The Federal Open Market Committee
FROM: The Secretariat

SUBJECT: Proposed clarifying revisions of continuing authority directive for open market operations.

The purpose of this memorandum, which has been prepared in consultation with the Committee's General Counsel, is to discuss certain problems with the language in the Committee's continuing authority directive under which System Open Market Account transactions are carried out implementing the current economic policy directive, and to propose clarifying revisions.

As a point of departure, it will be recalled that prior to December 19, 1961, transactions in the Account were governed by a single directive issued by the Committee at each meeting, embodying both (1) operating instructions of a generally continuing nature and (2) policy guidelines that were changed from time to time.

At its meeting in December 1961, the Committee adopted a revised procedure, under which operating instructions of a continuing nature were given in a continuing authority directive, and policy guidelines were provided at each meeting in a current economic policy directive.

The policy record entry for the December 1961 meeting contained the statement that "The language in the new continuing authority directive was rephrased from that of earlier instruments for the sake of greater clarity...." However, the new language poses certain problems that are discussed below.

1. The "leeway" proviso appended to paragraph 1 of the continuing authority directive states that-

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" . . . The aggregate amount of such U.S. Government securities held in such Account. . . shall not be increased or decreased by more than \$1 billion during any period between meetings of the Committee."^{1/} Emphasis added.

The phrase "during any period" is susceptible of at least three different interpretations:

- (1) At no time in the interval between meetings shall holdings of Government securities differ from the holdings on the day of the previous meeting by more than \$1 billion;
- (2) Regardless of the magnitude of interim fluctuations, the net change in Government security holdings between one meeting and the next shall not exceed \$1 billion; or
- (3) Between no two points in time in the interval between meetings may the holdings of Government securities differ by more than \$1 billion.

The Account Manager has interpreted the leeway provision in accordance with the first of these alternatives. This interpretation is consistent with the leeway provision in the single directive issued at meetings before December 19, 1961, which specified that-

" . . . the aggregate amount of securities held in the System Account . . . at the close of this date . . . shall not be increased or decreased by more than \$1 billion" Emphasis added.

It is clear that the Committee did not intend to change its instructions on this matter in adopting the new directive, since the policy record entry for the December 19, 1961, meeting declared that the Committee had made, with one

^{1/} On several recent occasions the \$1 billion limit temporarily has been increased to \$1.5 billion. For simplicity the figure of \$1 billion is used in this memorandum.

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exception not pertinent here, "no substantive changes in its authorizations and directions to the Account Manager". It would appear desirable to make the Committee's intent explicit in the directive.

2. The phrase "between meetings of the Committee" could lead to uncertainty as to the exact timing of the period during which the leeway restriction applies. The Account Manager has proceeded on the premise that a leeway, once established, is in effect from the close of business on the day of a Committee meeting through the close of business on the day of the next meeting. While this undoubtedly is the Committee's intent, the phrase "between meetings of the Committee" might be taken to imply that the leeway restriction applies to the period from the end of one meeting to the beginning of the next meeting. Thus, one could argue that the Account Manager technically has authority to effect transactions without limitation as to dollar amount on the day of Committee meetings. It would appear desirable to remove this ambiguity.

3. On rare occasions the Committee may hold a meeting in the course of which no action is taken with respect to a policy directive. One such occasion was the telephone conference meeting held on June 21, 1962, which was concerned exclusively with the Canadian problem.

The preamble to the present authority directive authorizes and directs the Account Manager to conduct specified operations-

"to the extent necessary to carry out the current economic policy directive adopted at the most recent meeting of the Committee." Emphasis added

Because the Manager's authority is now limited to carrying out the policy directive adopted at the most recent meeting, it is at least arguable that

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there is nothing for him to implement if no policy directive is adopted at a meeting, and his authority to effect any Account transactions thereafter may be subject to question. The directive can be amended to avoid this problem.

Recommendation

The following revisions of language in the authority directive would appear to resolve the problems discussed in this memorandum.

"1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the MOS' RECENT current economic policy directive adopted at the-most-recent A meeting of the Committee:

"(a)...; provided that the aggregate amount of such securities held in such Account ... AT THE CLOSE OF BUSINESS ON THE DAY OF A MEETING OF THE COMMITTEE AT WHICH ACTION IS TAKEN WITH RESPECT TO A CURRENT ECONOMIC POLICY DIRECTIVE shall not be increased or decreased by more than \$1 billion during any THE period between meetings-of-the-Committee COMMENCING WITH THE OPENING OF BUSINESS ON THE DAY FOLLOWING SUCH MEETING AND ENDING WITH THE CLOSE OF BUSINESS ON THE DAY OF THE NEXT SUCH MEETING."