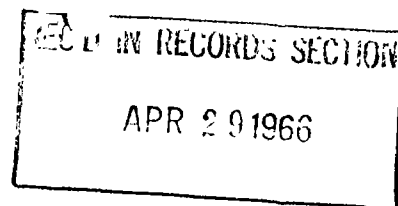




BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON



April 28, 1966.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Holland

SUBJECT: Revisions of proposed  
new instruments governing foreign  
currency operations

Attached are revised drafts of the new instruments governing System foreign currency operations proposed by the Secretariat in a memorandum to the Committee dated February 18, 1966.

The main revisions are those discussed at the meeting of the Committee on April 12, 1966. These consist of the addition of certain language to the first sentence of paragraph 3 of the Authorization and the deletion of certain language in paragraph 1(E) of the directive, both recommended by Mr. Young; and the addition of a new final paragraph to the Authorization (paragraph 10) relating to reporting requirements, along the lines of a suggestion by Mr. Heflin. One other textual change is proposed, involving a minor stylistic improvement in paragraph 2(A) of the directive. These changes are shown by use of cancelled type for deletions and capital letters for additions.

In addition, the dollar limit on commitments to deliver foreign currencies to the Stabilization Fund, given in paragraph 1(C)1 of the Authorization, has been changed from \$100 million to \$200 million equivalent to correspond to the amendment of the existing continuing authority directive made by the Committee at its April 12 meeting.

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

Robert C. Holland, Secretary,  
Federal Open Market Committee.

CONFIDENTIAL (FR)

REVISED DRAFT  
April 28, 1966

APR 29 1966

Proposed new Authorization for  
System foreign currency operations

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings  
Belgian francs  
Canadian dollars  
Pounds sterling  
French francs  
German marks  
Italian lire  
Japanese yen  
Netherlands guilders  
Swedish kronor  
Swiss francs

B. To hold foreign currencies listed in paragraph A above, up to the following limits:

- (1) Currencies held spot or purchased forward, up to the amounts necessary to fulfill outstanding forward commitments;
- (2) Other currencies held spot or purchased forward, up to the amount necessary for System operations to exert a market influence and not exceeding \$150 million equivalent; and

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(3) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to \$200 million equivalent.

C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:

(1) Commitments to deliver to the Stabilization Fund foreign currencies in which the United States Treasury has outstanding indebtedness, up to \$200 million equivalent;

(2) Commitments to deliver Italian lire, under special arrangements with the Bank of Italy, up to \$500 million equivalent; and

(3) Other forward commitments to deliver foreign currencies, up to \$275 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations

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with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

<u>Foreign Bank</u>	<u>Amount of Arrangement (millions of dollars equivalent)</u>	<u>Period of Arrangement (months)</u>
Austrian National Bank	50	12
National Bank of Belgium	100	12
Bank of Canada	250	12
Bank of England	750	12
Bank of France	100	3
German Federal Bank	250	6
Bank of Italy	450	12
Bank of Japan	250	12
Netherlands Bank	100	3
Bank of Sweden	50	12
Swiss National Bank	150	6
Bank for International Settlements (System drawings in Swiss francs)	150	6
Bank for International Settlements (System drawings in authorized European currencies other than Swiss francs)	150	6

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall be at prevailing market rates and; NO ATTEMPT SHALL BE MADE TO ESTABLISH RATES THAT APPEAR TO BE OUT OF LINE WITH UNDERLYING MARKET FORCES. Insofar as is practicable, foreign currencies shall be purchased through spot transactions when rates for those currencies are at or below par and sold through spot transactions when such rates are at or above par, except when transactions at other rates (i) are specifically authorized by the Committee, (ii) are necessary to acquire currencies to meet System commitments, or (iii) are necessary to acquire currencies for the Stabilization Fund, provided that these currencies are resold forward to the Stabilization Fund at the same rate.

4. It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making

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operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in accordance with Section 14(e) of the Federal Reserve Act.

6. A Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) is authorized to act on behalf of the Committee when it is necessary to enable the Federal Reserve Bank of New York to engage in foreign currency operations before the Committee can be consulted. All actions taken by the Subcommittee under this paragraph shall be reported promptly to the Committee.

7. The Chairman (and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors) is authorized:

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A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities; and

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

10. THE SPECIAL MANAGER OF THE SYSTEM OPEN MARKET ACCOUNT FOR FOREIGN CURRENCY OPERATIONS SHALL KEEP THE COMMITTEE INFORMED ON CONDITIONS IN FOREIGN EXCHANGE MARKETS AND ON TRANSACTIONS HE HAS MADE AND SHALL RENDER SUCH REPORTS AS THE COMMITTEE MAY SPECIFY.

CONFIDENTIAL (FR)

REVISED DRAFT  
April 28, 1966.

Proposed new Foreign currency directive

1. The basic purposes of System operations in foreign currencies are:
  - A. To help safeguard the value of the dollar in international exchange markets;
  - B. To aid in making the system of international payments more efficient;
  - C. To further monetary cooperation with central banks of other countries having convertible currencies, with the International Monetary Fund, and with other international payments institutions;
  - D. To help insure that market movements in exchange rates, within the limits stated in the International Monetary Fund Agreement or established by central bank practices, reflect the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public; and
  - E. To facilitate growth in international liquidity in accordance with the needs of an expanding world economy, ~~by providing for reciprocal holdings of currencies.~~
2. Unless otherwise expressly authorized by the Federal Open Market Committee, System operations in foreign currencies shall be undertaken only when necessary:

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A. To cushion or moderate fluctuations in the flows of international payments, if such fluctuations ~~are~~ (1) ARE deemed to reflect transitional market unsettlement or other temporary forces and therefore are expected to be reversed in the foreseeable future; and (2) are deemed to be disequilibrating or otherwise to have potentially destabilizing effects on U.S. or foreign official reserves or on exchange markets, for example, by occasioning market anxieties, undesirable speculative activity, or excessive leads and lags in international payments;

B. To temper and smooth out abrupt changes in spot exchange rates, and to moderate forward premiums and discounts judged to be disequilibrating. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a reassessment by the Committee of supply and demand forces;

C. To aid in avoiding disorderly conditions in exchange markets. Special factors that might make for exchange market instabilities include (1) responses to short-run increases in international political tension, (2) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, and (3) market rumors of a character likely to stimulate speculative transactions. Whenever exchange market instability threatens to produce disorderly conditions, System transactions may be undertaken



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if the Special Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Special Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for System foreign currency operations; and

D. To adjust System balances within the limits established in the Authorization for System foreign currency operations in light of probable future needs for currencies.

3. System drawings under the swap arrangements are appropriate when necessary to obtain foreign currencies for the purposes stated in paragraph 2 above.

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.