



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

CONFIDENTIAL (FR)

August 7, 1968.

To: Federal Open Market Committee      Subject: System lending of U.S.  
Government Securities.  
From: The Secretariat

On August 6, 1968 the System Account Manager distributed a memorandum, with three attachments, on the subject of System lending of Government securities. It is expected that the memorandum will be considered at the Committee's August 13 meeting, in connection with item 8 of the agenda.

If the Committee approves the first of the Manager's two recommendations, that the continuing authority directive be amended to authorize the lending of securities from the System Account under terms and conditions to be established by the Committee, it may wish to do so by adding the following paragraph at the end of the existing continuing authority directive:

"3. 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."

As noted in his memorandum, the Manager's second recommendation is that the Committee establish the terms and conditions described there (under the headings "Dealer Delivery Failures" and "Securities Clearing Arrangement") as those under which the lending of securities is authorized, on the understanding that possible changes may be submitted for Committee consideration after discussions are held with Government securities dealers.

REC'D IN RECORDS SECTION  
AUG 7 - 1968

To Federal Open Market Committee

August 6, 1968

From Alan R. Holmes, Manager  
System Open Market Account

Subject: System Lending of U. S.  
Government Securities

The Steering Committee of the Treasury-Federal Reserve Study of the Government Securities Market has recommended adoption of the proposal, outlined in memoranda previously submitted to the Federal Open Market Committee, that the Federal Reserve System from time to time lend portions of its holdings of United States Government securities to dealers and to nondealer banks participating in the clearing arrangement operated by the Federal Reserve Bank of New York. The two purposes of lending System owned securities would be (1) to enable dealers to avoid delivery failures and (2) to facilitate the securities clearance arrangement of the Federal Reserve Bank of New York. It is anticipated that most of the lending activity will arise from delivery failures (1), and that a negligible amount will arise in connection with the securities clearance arrangement (2). This memorandum describes the terms and procedures of such lending operations.

Dealer Delivery Failures

Securities in the System Open Market Account will be loaned to Government securities dealers with whom the Federal Reserve Bank of New York does business to enable them to make deliveries in cases where they have sold securities purchased from another customer who has failed to deliver the securities to the dealer in a timely fashion. In order to guard against abuses of the privilege, the lending will be limited to short periods and to situations where the dealer has contracted to acquire the securities at the time he contracted to make the delivery and is not selling them short. In addition, the amounts, both in total and as to any one dealer and transaction, will be limited with the idea of liberalizing these limits if circumstances warrant. Such lending will be governed by the following procedures.

1. The dealer will certify that he is unable to deliver securities as contracted, that such securities were not sold short, and that they cannot be readily borrowed elsewhere.
2. Securities Department will negotiate the loan of the securities involved for periods not to exceed three days, up to \$50 million par value of Treasury bills or \$10 million par value of coupon issues per transactions per dealer, or less if the System Account holdings were less. An initial maximum of \$75 million will be placed on the total of loans to one dealer.
3. Collateral will be taken for the System Open Market Account in securities of greater value and it may be acquired and held by the System Open Market Account or sold in the market in the event of default by the borrower.
4. No entries will be made on the System Open Market Account books other than a notation that the particular securities have been loaned.

5. The lending charge will be at the rate of  $5/8$  per cent per annum per day,  $1/8$  per cent above the standard market charge for lending securities, in order to discourage unnecessary use of the privilege.
6. Loan contracts will be renewed only under exceptional circumstances, if the Securities Department is satisfied of the need.

#### Securities Clearing Arrangement

The Federal Reserve Bank of New York is operating an arrangement for clearing transactions in United States Government securities between banks in New York City. Government securities held in the System Open Market Account will be loaned to a participating bank in the event such participant finds it impossible to deliver securities which he owes the Federal Reserve Bank at the end of each day. Such lending will be governed by the following procedures.

1. The Government Bond Department of the Federal Reserve Bank of New York will certify to the Securities Department that one of the participants in the clearing arrangement is unable to deliver certain Government securities, either bill or coupon issues, needed to settle the clearing.
2. The Securities Department will arrange to lend the participant the needed securities overnight against the receipt of other United States securities of greater value which will be held for the System Open Market Account as collateral in lieu of the securities loaned. No entries will be made on the System Open Market Account books other than a notation that the particular securities have been loaned. The contract will provide for the acquisition and sale of the collateral by the System Account.
3. The borrower will be charged at the rate of  $5/8$  per cent per annum for each day the loan is outstanding. The income will not be participated among the Reserve Banks.
4. The loan of securities will be renewed only under exceptional circumstances if the Securities Department is satisfied of the need, and then only on a day-to-day basis.

#### Documentation

The following is a list of various documents proposed to be used in connection with the above described lending operations.

1. Draft of letter for Mr. Hayes' signature to the Presidents of the other Federal Reserve Banks requesting that they authorize the Federal Reserve Bank of New York to lend securities from the System Open Market Account, in accordance with the directions of the Federal Open Market Committee. Prior to the start of lending operations this letter will be sent to each President, to be signed and returned indicating authorization by each Reserve Bank.

2. Form of contract for the lending of securities overnight.
3. Form of contract for the lending of securities for more than one day.

Tentative drafts of the above documents are attached. Since the details of the proposal are subject to discussion and negotiation with the interested dealers and banks, the documents may have to be revised before they are finally adopted.

Recommendations

1. It is recommended that the Federal Open Market Committee amend the continuing authority directive to authorize the lending of securities from the System Open Market Account under terms and conditions to be established from time to time by the Committee.
2. It is also recommended that the Committee authorize the lending of securities under the terms and conditions described above, with the understanding that any changes that may be indicated by discussions with the Government securities dealers will be submitted for the consideration of the Committee.

DRAFT OF LETTER FROM MR. HAYES TO THE  
PRESIDENT OF EACH FEDERAL RESERVE BANK  
IN CONNECTION WITH LENDING SECURITIES  
FROM THE SYSTEM OPEN MARKET ACCOUNT

Dear :

Reference is made to the action of the Federal Open Market Committee on , 1968, authorizing the lending of United States Government securities from the System Open Market Account, and to the "Plan for Securing Federal Reserve Notes by Pledge of Participations (Undivided Interests) in Direct Obligations of the United States in System Open Market Account" set forth in the letters of the Board of Governors to Federal Reserve Agents and Presidents of Federal Reserve Banks, dated September 4, 1943 and March 26, 1963, respectively (Federal Reserve Loose Leaf Service # 5827.1).

As you know, the present authorization of the Federal Open Market Committee contemplates that Government securities will be loaned by Federal Reserve Bank of New York in its own name from the System Open Market Account to Government securities dealers who are unable to deliver securities which they have contracted to sell and to banks participating in the arrangement for clearing Government securities in New York which are unable to deliver to this Bank securities that they are obligated to deliver as a result of the daily settlement pursuant to the clearing arrangement. Loans of Government securities would be secured by Government securities of equal or greater market value.

The lending of securities from the System Open Market Account seems to be consistent with the above-mentioned Plan For Securing Federal Reserve Notes (see paragraph (6) of the Plan) and, accordingly, no amendment of the Plan appears to be necessary. However, since this Bank will act as agent of

2

all the Federal Reserve Banks in lending securities from the System Open Market Account, it appears desirable that this Bank receive express authorization from each Federal Reserve Bank to make such loans.

Would you please, therefore, indicate your authorization to this Bank to lend Government securities from the System Open Market Account in accordance with the authorizations and directions of, and regulations adopted by, the Federal Open Market Committee, as such authorizations, directions and regulations now exist or may from time to time be amended, by signing the enclosed copy of this letter in the space provided therefore and returning the same to us.

Yours sincerely,

Alfred Hayes  
President

Enclosure

Federal Reserve Bank of \_\_\_\_\_

By \_\_\_\_\_

Date \_\_\_\_\_

DRAFT OF CONTRACT FOR OVERNIGHT  
LENDING OF SECURITIES

Federal Reserve Bank of New York  
33 Liberty Street  
New York, New York 10045

Gentlemen:

We hereby confirm our agreement with you whereby you agreed to lend to us and we agreed to borrow from you today, the following United States Government securities (the borrowed securities):

As collateral security for our obligations hereunder we have pledged with you the following United States Government securities (the collateral):

The borrowed securities or securities of the same principal amount of the same issue shall be returned to you on your business day next succeeding the date hereof (the expiration date). Upon such return, the collateral or securities of the same principal amount of the same issue shall be delivered to us.

It is agreed that we are to pay you for each day, including the day of borrowing, until the expiration date, a sum equal to interest at the rate of five-eighths of one per cent per annum of the principal amount of the borrowed securities. It is also agreed that if we shall not have returned the borrowed securities on the expiration date, then we are to pay you for each day, including the expiration date, until the borrowed securities are returned or the collateral sold as hereinafter provided, a sum equal to interest at the rate of 6 per cent per annum of the principal amount of the borrowed securities.

2

It is further agreed that, in the event that we shall not have returned the borrowed securities on the expiration date, you may, at any time after the expiration date, at your option sell the collateral and apply the proceeds towards satisfaction of our liability to you, which shall be the fair market value on the expiration date of the borrowed securities plus interest computed at the above-mentioned rates.

In confirmation of this agreement, and as a receipt for the securities we have pledged hereto, please sign and return to our messenger the enclosed copy of this letter.

Yours very truly,

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(Official signature)

Federal Reserve Bank of New York

BY

DRAFT OF CONTRACT FOR LENDING OF  
SECURITIES FOR MORE THAN ONE DAY

Federal Reserve Bank of New York  
33 Liberty Street  
New York, New York 10045

Gentlemen:

We hereby confirm our agreement with you whereby you agreed to lend to us and we agreed to borrow from you today, the following United States Government securities (the borrowed securities):

As collateral security for our obligations hereunder we have pledged to you the following United States Government securities (the collateral):

The borrowed securities or securities of the same principal amount of the same issue shall be returned to you, upon your demand, or, in the event no demand is made, on, or at our option prior to \_\_\_\_\_ (the expiration date). Upon such return, the securities which we have pledged with you or securities of the same principal amount of the same issue shall be delivered to us. The amount represented by coupons upon the borrowed securities which mature prior to the date on which the borrowed securities are to be returned hereunder shall be remitted to you on the maturity date of such coupons; and the amount represented by coupons upon the collateral which mature prior to such date shall be remitted to us on the maturity date of such coupons.

It is agreed that we are to pay you for each day, including the day of borrowing, until the timely return of the borrowed securities in accordance with the provisions hereof, a sum equal to interest at the rate of five-eighths of one per cent per annum of the principal amount of the borrowed securities.

It is also agreed that if we do not make timely return of the borrowed securities in accordance with the provisions hereof, then we are to pay you for each day (including the day on which the borrowed securities should have been returned) until the borrowed securities are returned or the collateral sold, as hereinafter provided, a sum equal to interest at the rate of 6 per cent per annum of the principal amount of the borrowed securities.

It is further agreed that, in the event that we shall not have made timely return of the borrowed securities in accordance with the provisions hereof, you may, at any time, at your option sell the collateral and apply the proceeds towards satisfaction of our liability to you, which, in the event of such a sale, shall be the fair market value of the borrowed securities on the expiration date or date of demand, plus interest computed at the above-mentioned rates.

We hereby certify that we are borrowing the above-mentioned securities in order to enable us to fulfill our obligation under a contract to sell and deliver such securities today, that such securities are not to be used in connection with a short sale, and that we are unable to borrow such securities elsewhere.

In confirmation of this agreement, and as a receipt for the collateral we have pledged hereto, please sign and return to our messenger the enclosed copy of this letter.

Yours very truly,

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(Official signature)

Federal Reserve Bank of New York

BY