

March 27, 1947.

Chairman Eccles:

Mr. Rouse, Mr. Musgrave and I went to the Treasury yesterday, and Mr. Bartelt read the opinion which I had prepared regarding the legality of exchanges of Treasury bills. We had a helpful discussion of the subject with Mr. Bartelt and he asked that you send a copy of the opinion over to him with a letter of transmittal. He said he would take the matter up with the Treasury's General Counsel and then with the Secretary. I attach a suggested letter transmitting a copy of the opinion to him and a copy of the brief memorandum on the mechanics of the transaction prepared by Messrs. Rouse and Musgrave. I may say for your information that Walter Logan told me over the telephone that he was in entire agreement with my opinion on this subject.

GB ✓

Attachment

March 28, 1947.

Mr. Edward F. Bartelt,
Fiscal Assistant Secretary,
Treasury Department,
Washington 25, D. C.

Dear Mr. Bartelt:

Under date of March 10, 1947, I sent to you a memorandum dated February 28, 1947, regarding proposed changes in Treasury bill policies. I now enclose for your information a copy of an opinion of the General Counsel of the Federal Open Market Committee as to the legality of the exchange by Federal Reserve Banks of maturing Treasury bills for new bills as proposed in that memorandum, together with a copy of a brief memorandum of the mechanics of such an exchange.

Sincerely yours,

M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosures

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3/27/47

THIS COPY FOR CHAIRMAN ECCLES

Date March 26, 1947.

To Mr. Eccles, Chairman,
Federal Open Market Committee

Subject: Exchange of Treasury Bills by

From Mr. Vest

Federal Reserve Banks.

In order to simplify the weekly refunding operations of the Treasury by permitting holders of maturing bills to exchange them for new issues of bills the following proposal is under consideration: The Treasury would provide in its circulars or regulations that bills awarded on tenders could be paid for either by cash or by surrender of a like face amount of the maturing issues of bills, with an adjustment for the discount. This privilege would be offered to all holders, including Federal Reserve Banks. In cases where the holders tendered maturing bills in exchange for new bills the holders (whether Federal Reserve Banks or others) would receive payment from the Treasury for the difference between the redemption value of the maturing bills (par) and the discounted value of the new bills. Where the holders receive a full allotment, the amount of this payment would be the amount deducted by way of discount from the face amount of the new bills and where the holders are awarded only partial allotments by the Treasury the amount of this payment would, of course, include in addition the amount of the Treasury bills redeemed and not exchanged.

The question is raised whether this proposal for the exchange, directly with the Treasury, of maturing bills held by the Federal Reserve Banks for new issues of bills is permissible under the law without counting such exchanges in computing the amount of Government obligations acquired by Federal Reserve Banks directly from the United States.

Opinion

In my opinion, exchanges by Federal Reserve Banks of maturing Treasury bills for newly issued bills in the manner described above is permissible under the provisions of the law, and such exchanges do not have to be counted in computing the amount of Government obligations acquired by the Federal Reserve Banks directly from the United States.

Discussion

The provisions of section 14(b) of the Federal Reserve Act authorize the purchase and sale of obligations of the United States by the Federal Reserve Banks. Such purchases and sales must be in the open market, except that until March 31, 1947 (unless further extended by Congress) purchases may be made directly from the United States up to an aggregate amount held at any one time of \$5,000,000,000.

The question of exchanges, directly with the Treasury, of Government obligations held by the Federal Reserve Banks for new Government obligations has been the subject of previous legal opinions rendered to the Federal Open Market Committee. On January 26, 1937, Mr. Dreibelbis, then Assistant General Counsel of the Committee, reached the conclusion that exchanges of Government obligations permitted under Treasury circulars may be made directly with the Treasury for new Government obligations. On October 27, 1942, Mr. Wyatt, then General Counsel of the Committee, rendered an opinion to the effect that obligations acquired through such exchanges do not have to be counted in computing the amount subject to the \$5,000,000,000 limitation contained in the law, and that this is true regardless of whether the obligations are in the form of bonds, certificates, or bills. On October 30, 1942, Mr. Dreibelbis stated that a plan for replacing maturing certificates was legally permissible under which, while the holders of maturing certificates have no preemptive rights with respect to new certificates, those holders who happen also to be successful subscribers for new certificates were to be allowed to pay for the new certificates by turning in their maturing certificates; and that this would likewise apply to an exchange of bills.

I have reviewed and considered the various opinions discussed above and am in agreement with the conclusions expressed. Without undertaking to restate the considerations set forth in those opinions, it may be said briefly that the power of the Federal Reserve Banks to make exchanges of obligations directly with the Treasury would seem to result from the authority given the Reserve Banks by section 14(b) of the Federal Reserve Act taken in connection with their authority under section 4 of the Act to exercise "such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act". Since this power existed prior to 1942, it seems clear that it continued to exist after the amendment in that year permitting Reserve Banks to buy up to \$5,000,000,000 of Government obligations directly from the Treasury. That amendment was liberalizing rather than restrictive and is to be construed accordingly.

A study of the legislative history of the requirement of section 14 of the Federal Reserve Act that purchases be made in the open market shows that its principal purpose was to prevent the Treasury from acquiring unlimited new funds by the simple process of borrowing them from the Federal Reserve Banks without the necessity for going to the public. The requirement appears to have been aimed against financing by the Government otherwise than on a free and open market and not against the practice of exchanging obligations previously acquired in the open market. Under the present proposal the bills obtained through exchanges by the Federal Reserve Banks would merely be substituted for those which they had previously purchased in the open market. Thus the proposal would not violate the primary purpose of the requirement that purchases be in the open market.

As a matter of fact, for a number of years past, both before and after the amendment to the law enacted in 1942 permitting direct purchases from the Treasury up to \$5,000,000,000, Federal Reserve Banks have frequently exchanged directly with the Treasury certificates, notes, and bonds which they had previously acquired in the open market for other obligations of the Treasury of the same par value (or a smaller par value if partial allotments were made by the Treasury).

The only significant difference between the proposal now under consideration and the exchanges of Government obligations which have been made in the past arises from the fact that certificates, notes, and bonds ordinarily bear interest coupons, whereas Treasury bills are issued on a discount basis. This in my opinion has no effect upon the legality of the direct exchanges between the Federal Reserve Banks and the Treasury. In the case of Treasury notes and bonds, for example, some such maturing obligations having a certain face amount have been exchanged for Treasury certificates having the same face amount but having coupons attached for higher or lower rates of interest than were borne by the maturing Treasury notes and bonds. In the case of Treasury bills an obligation having a certain face amount is exchanged for a like obligation having the same face amount if held to maturity, the difference between the discounted price and the face amount being paid to the Federal Reserve Banks. In each case the Federal Reserve Banks give up a maturing obligation and receive another obligation of the same corresponding value, subject to an adjustment for interest to accrue in the future. In neither case does the amount of Government obligations held by the Federal Reserve Banks after the transaction exceed the amount of the same type of Government obligations which were previously held and which were originally acquired by the Federal Reserve Banks in the open market.

Under the present proposal, in response to a request from the Treasury addressed to Federal Reserve Banks and others for tenders for new issues of bills, the Reserve Banks would advise the Treasury that they are willing to accept for maturing bills which they hold other bills which will have an equal face amount at maturity and in addition a certain amount in cash representing the adjustment for interest. The net result, if the offer is accepted, is that instead of receiving cash for the entire face amount of their maturing bills Federal Reserve Banks would receive in exchange a small amount of cash representing discounted interest together with new Treasury bills having a face amount equal to the face amount of those turned in.

The fact that the Reserve Banks bid for the new securities does not in my judgment affect the fact that the transaction is a legally permissible exchange. The bid is merely a statement of the amount of the adjustment for interest which the Federal Reserve Bank is willing to

accept. It affects the amount of the cash which the Reserve Banks receive from the Treasury, but it does not affect the face amount of the bills received. The exchanges which have been made in the past have sometimes involved turning in by the Federal Reserve Banks of one type of obligation and the receipt by them of another type of obligation. Sometimes the obligations received have differed as to maturities or as to rates, or both, from the same kind of maturing obligations delivered to the Treasury. Thus the fact that, as a result of a bid, the bills acquired in exchange may bear a different rate of discount from those turned in does not bring any new element into the situation from a legal standpoint. Where bids are used the Reserve Banks make the offer; where coupon issues are exchanged the Treasury makes the offer. Whether there is an exchange of bills or of coupon securities and whether the exchange is made pursuant to an offer by the Federal Reserve Banks or pursuant to an offer by the Treasury, the Reserve Banks would in no case receive a greater face amount of obligations than the face amount of the maturing obligations which they turn in to the Treasury.

It seems clear from this analysis of the transaction that an operation involving a bid and an adjustment by way of a discount is just as much an exchange as is an operation involving obligations with coupons attached. The practice of exchanging obligations with coupons attached has prevailed for years past, and the fact that such exchanges are made was reported to Congress as early as 1937. For the reasons stated I have reached the conclusion indicated above that the proposal involves a legally permissible exchange.

Mechanics in connection with new issues
of Treasury Bills on "exchange" tenders.

Under this plan the Treasury would offer weekly a fixed amount of a new issue of Treasury bills for which bills awarded on tenders could be paid for either by cash or surrender of a like face amount of the maturing issue of Treasury bills. In cases where the investor tendered the maturing issue for the new issue, the investor would receive payment from the Treasury (through the Federal Reserve Banks) for the difference between the redemption value of the maturing issue (par) and the purchase price of the new issue.

New issues of Treasury bills would be sold on a discount basis under competitive bidding as in the past. No preferential allotment would be made on tenders for which an exchange is to be made by surrender of a maturing issue. Full allotments for small amounts on a fixed price basis could be continued.

Tenders for new issues of Treasury bills may be entered by the System Open Market Account, and, according to an opinion by General Counsel of the Federal Open Market Committee, awards of an amount not in excess of maturing bills held by the Federal Reserve Banks may be acquired directly from the Treasury without coming under the \$5,000,000,000 statutory limitation for direct purchases from the Treasury, provided the new bills are issued against surrender of the maturing issue of Treasury bills.

When it is decided to discontinue the buying and repurchase option on bills, bills held in the option accounts would be transferred into the system account in the course of a 13 weeks cycle.

3/26/47

April 1, 1947

Honorable John W. Snyder,
Secretary of the Treasury,
Washington, D. C.

Dear John:

At today's meeting, the Executive Committee of the Federal Open Market Committee considered the money and security market outlook and the prospective developments of Treasury finance during the current quarter. The Committee concluded that it would be desirable to utilize funds accumulated in Treasury balances with commercial banks for the purpose of redeeming maturing bill issues during this period, in order to counteract excessive ease in the money market.

The Committee recommends the retirement of 200 million dollars of maturing Treasury bill issues weekly for the next four weeks. It is also suggested that, if prospects for Treasury expenditures and receipts justify, 100 million of maturing bills be paid off weekly during the subsequent weeks of May and June, in addition to a substantial cash payment on the June 1 certificate issue. In order to make this program effective as a means of absorbing reserves, funds needed to retire bills should be obtained through calls on war loan deposits.

If this recommendation is accepted, it is further suggested that the Treasury announce to the public that 200 million of the following weeks' Treasury bill issue is to be redeemed as part of its program of debt reduction, without announcing in advance a detailed program of amounts and duration of bill retirements. In view of the condition of the market, we believe it wise to create this element of uncertainty.

Honorable John W. Snyder

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Current estimates indicate that a program of this kind would leave the Treasury with an adequate balance at the end of the fiscal year. Assuming retirement of 1.6 billion dollars of bills in the next three months and of 1 billion of certificates in June, it appears that the Treasury balance at the end of the period will still be well above 2 billion, with war loan deposits of about 1 billion.

With kindest regards, I am,

Sincerely yours,

M. S. Eccles, Chairman,
Federal Open Market Committee.

RAM:th

April 2, 1947

Mr. Edward F. Bartelt,
Fiscal Assistant Secretary,
Treasury Department,
Washington, D. C.

Dear Mr. Bartelt:

I am enclosing a copy of a letter containing suggestions on debt retirement by the Executive Committee of the Federal Open Market Committee which I am sending to the Secretary today.

Sincerely yours,

H. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosure