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Chairman Eccles

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Replacement of maturities

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If the Treasury is agreeable to direct replacement of maturities by the System, the mechanical arrangements on issues other than bills would be simple. In the offering circular the Treasury would place the System in the category of nonbanking investors, whose subscriptions are allotted in full, rather than in the category of commercial banks. A concurrent public announcement would be made that the purpose of this change was to enable the System to replace maturities, and the amount of the System's holdings of the maturing issue would be stated. The amount allotted on commercial bank subscriptions for over \$100,000 would be reduced by the System's subscription as well as by the bank subscriptions for \$100,000 and less and the nonbank subscriptions.

The Treasury should also shift the dealers from the full allotment to the percentage allotment basis for securities available to commercial banks. In the December financing dealers and brokers subscribed for 881 million dollars of marketable securities. Of this total 115 million dollars was for 2 1/2 per cent bonds, which were subsequently sold to nonbanking investors. It is likely that most of the remaining 766 million dollars was sold to commercial banks. In the recent certificate offering the dealers subscribed for 220 million dollars, most of which probably went to commercial banks. The profit on this transaction may have amounted to about \$250,000. It seems to me that the fact that commercial banks in both instances bid for securities in addition to their allotments provides a strong argument that excess reserves are still considerably above the level that is necessary in order to obtain the widest possible distribution among nonbanking investors.

If the Treasury offers bills at a flat rate of $\frac{3}{8}$ of 1 per cent, the mechanical arrangements for direct replacement of maturities would be similar to those on other securities. If the Treasury continues to sell bills on a bid basis, it would be necessary to arrange for the rate at which the System's replacements would be made. A rate of $\frac{3}{8}$ of 1 per cent would result in criticism that the System was being given a preferential rate over other investors. The average rate at which other bids were accepted probably would be the most satisfactory basis. In the announcement of the new offering on each Friday the Treasury would state the amount of the System's holdings as of the previous Wednesday. The amount allotted to the public would be reduced by the System's subscription.

Some arguments may be presented for replacing all, part, or none of each maturity depending on circumstances. The demand for new issues fluctuates widely from time to time. The System's holdings of each issue vary widely and may have no relation to the demand for new issues. There would be some advantage in relating the amount of each replacement to the current investor demand rather than to the amount of maturities that the System happens to hold. On the other hand,

it would be difficult to estimate in advance the demand for each new issue. Each member of the executive committee might well have a different idea as to the amount, and time would be consumed in deciding the question on each issue. Perhaps the best solution would be to replace maturities in full and to sell freely from the System's holdings if a demand develops as well as to buy freely if the new issues are in supply.

Under the recent opinions by Mr. Wyatt and Mr. Dreibelbis the replacement of maturing certificates is considered to be an exchange and not a direct purchase. It is my understanding that the replacement of maturing bills would also be considered as an exchange if the Federal Reserve tenders of the maturing bills in payment for the new bills. This interpretation would not be affected by the fact that the exchange is not of par for par and would involve a payment by the Treasury to the Federal Reserve.

The question of giving rights on certificates raises the old arguments for and against rights that were discussed a year or more ago. Rights do give the long-term investor a preferred position in replacing maturities and probably encourage the holding of issues until maturity. On the other hand, they encourage speculation on the basis of the price of the new issue and enable dealers and other traders to make an unreasonable profit out of Treasury financing.