Reserve Position

methods of adjustment

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PREFACE

The material presented in this thesis represents the personal views and opinions of the writer. Nothing contained herein should be construed as reflecting the views or policies of the Federal Reserve Bank of Boston or the Board of Governors of the Federal Reserve System.

Edward J. McCarthy

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CHAPTER I

PURPOSE

The purpose of this paper is to acquaint member country banks and others with the various sources of short-term credit and the several investment outlets for short-term funds as a means, on the one hand, of insuring the ready availability of reserve funds to meet temporary and seasonal needs and, on the other, of providing profitable employment of excess reserve funds in order to maximize earnings. In particular, a brief description of the nature and purpose of so-called "money market instruments" will be presented, as the use of these near-money assets has become increasingly important in the efficient management of a bank's money position and required reserve account. A portion of a commercial bank's deposits tends to be volatile in varying degrees and, for this reason, a bank should plan to be in a position to convert quickly a portion of its assets into cash, either through outright sale or by pledge of assets to secure short-term borrowing at the lowest going rate. While the larger country banks are presumed to be familiar with the *money market,* experience suggests that many of the smaller country banks would profit from a review of the available sources of short-term funds and outlets for employing excess funds in short-term earning assets with a minimum of risk.

In the following pages we shall first review briefly the nature of reserves maintained by member banks at the Federal Reserve Bank, the method of computing the reserves that are required by law to be maintained (either at the Reserve Bank or in vault cash), and the nature and significance of excess reserves.

Next, the paper will describe a number of "money market instruments" and will outline the basic procedure of their use in the banking system and, in particular, in the management of the reserve position of a country member bank. In recent years an increasing number of banks has discovered the Federal Funds market as both a source of reserve funds and an outlet for the investment of excess reserves. Many others adjust their positions through the purchase and sale of Treasury Bills. The most important money market instruments, in addition to Federal Funds and Treasury Bills, include bankers' acceptances, commercial paper, and negotiable certificates of deposit. The increasing volume of Federal Funds transactions, and

SHORT-TERM RATES – Illustration A

FEBRUARY 2, 1970

APPROXIMATE SHORT–TERM RATES
(Daily Average)

Date	Discount Rate	Prime Rate	4 to 6 Months Commercial Paper*	Treasury Bills	Fed Funds
1945	½ to 1	1½	.75	.37	
1946	1	1½	.81	.37	
1947	1	1¾	1.03	.60	
1948	1½	2	1.44	1.04	
1949	1½	2	1.48	1.10	
1950	1¾	2¼	1.45	1.22	
1951	1¾	3	2.17	1.55	
1952	1¾	3	2.33	1.76	
1953	2	3¼	2.52	1.93	
1954	1½	3	1.58	.95	
1955	2½	3½	2.18	1.75	1.78
1956	3	4	3.31	2.65	2.73
1957	3	4½	3.81	3.26	3.11
1958	2½	4	2.46	1.83	1.57
1959	4	5	3.97	3.40	3.30
1960	3	4½	3.85	2.92	3.22
1961	3	4½	2.97	2.37	1.96
1962	3	4½	3.26	2.77	2.68
1963	3½	4½	3.55	3.15	3.18
1964	3½	4½	3.97	3.54	3.49
1965	4	4½	4.38	3.95	4.08
1966	4½	5¾	5.55	4.88	5.07
1967	4¼	5¾	5.11	4.32	4.23
1968	5¼	6¼	5.89	5.35	5.66
1969	5⅞	8	7.85	6.75	8.20
PEAK	6	8½	9.12	8.10	12.00

*Averages of daily offering rates of dealers

purchases and sales of Treasury Bills and other "money market instruments" has greatly expanded the volume of funds cleared through the Wire Transfer Department of the Federal Reserve Banks; for example, on an average day over $900 million are transferred through the Federal Reserve Bank of Boston.

The money market is located in lower Manhattan, covering about seven blocks, on streets named Cedar, Pine, Liberty, Nassau, Broad, Williams, Beaver, and Wall. In this area is the New York Stock Exchange, the commodity dealers, the municipal and corporate bond dealers, and the investment bankers; also the following, with which we will be principally concerned: the large money market banks, the dealers in U.S. Government securities and the Open Market Account at the Federal Reserve Bank of New York.

The use of a correspondent bank, both as a source of credit and as an outlet for excess funds, will also be discussed. Finally, we will review the function of the Federal Reserve discount window as a basic source of credit for temporary adjustment of the reserve account.

CHAPTER II

RESERVES

Description of Required Reserves

Commercial banks are required by law and custom to hold as reserves an amount of uninvested funds, or in some cases specified securities, equal to a certain percentage of their deposits. As of this writing, member banks in the Federal Reserve System are required to maintain reserves in the form of balances at the Federal Reserve Bank and/or currency and coin in their own vaults at least equal to the following percentages of demand and time deposits:

Reserve City Banks	
Demand Deposits up to $5 million	17 %
Demand Deposits in excess of $5 million	17½%
Time Deposits up to $5 million	3 %
Other Time Deposits	6 %

Country Banks	
Demand Deposits up to $5 million	12½%
Demand Deposits in excess of $5 million	13 %
Time Deposits up to $5 million	3 %
Other Time Deposits	6 %

At the present time, reserve requirements are established by the Board of Governors within the following range:

Reserve City Banks

	Minimum %	Maximum %
Demand Deposits	10	22
Time and Savings Deposits	3	10

Country Banks

	Minimum %	Maximum %
Demand Deposits	7	14
Time and Savings Deposits	3	10

Both city and country banks' reserve periods end on Wednesday. It is not necessary for a bank to maintain its required reserve each day as long as its average reserves equal the required reserve for the 7-day period.

The major part of member bank required reserves is in the form of deposits (reserve balances) at the Federal Reserve Banks. Currency and coin held in the vaults of a member bank may also be counted as legal reserves. For the individual bank, reserve balances serve as clearing accounts. Member banks may increase their reserve balances by depositing checks, currency, or by having a corespondent bank transfer by wire funds to the reserve account. Likewise a bank may draw against the account by authorization to charge for the payment of a cash letter, the purchase of securities, a draft on the Federal Reserve Bank, or by transfer of funds to another bank either in a bank's own Federal Reserve District or some other district. In many respects, reserves are similar to any individual or corporation balances maintained at their commercial bank.

Computation of Reserve Position

On September 12, 1968, the method of computing reserve requirements was changed so that all member banks would settle weekly, using average close-of-business deposits two weeks earlier, in calculating the weekly average required reserves for the current period. This change appears to have had both advantages and disadvantages for the member banks.. On the one hand, a bank knows prior to the beginning of each reserve period what its reserve requirement is for that period; and this removes uncertainties and deadlines existing under the former method when required reserves were computed against deposits held in the same period. On the other hand, the two-week "lag" has created a problem in the timing of available funds for many banks, particularly during periods of declining deposits when the higher reserve requirement calculated against deposit levels prevailing two weeks earlier must be met in subsequent periods when flows of available funds are reduced because of the deposit withdrawals.

The Federal Reserve Bank of Boston distributes to its member banks a form entitled "Work Sheet for Computing Cumulative Reserve Position," Form No. B-93. This form is made up in three sections:

(1) Deposits and vault cash
(2) Reserve requirements for current period
(3) Computation of reserve position for current period

I think it would be well to briefly discuss Section (1), and I believe Sections (2) and (3) are self-explanatory.

Gross Demand Deposits

Column 1 - Should include deposits of commercial banks, both member and nonmember, mutual savings banks, and balances in foreign countries.

Column 2 - Should include deposits in your treasury, tax and loan account, proceeds from U.S. Bond subscriptions, proceeds from sale of U.S. Savings Bonds, withheld income, Federal and Social Security tax deposits.

COMPUTING RESERVE POSITION — Illustration B

B-93 **Reserve Period No. 1**

WORK SHEET FOR COMPUTING CUMULATIVE RESERVE POSITION — PERIOD ENDING 1/7/70

PERIOD 1	PERIOD 2	PERIOD 3	PERIOD 4
BASE PERIOD ENDED 12/24/69	PRIOR PERIOD ENDED 12/31/69	CURRENT PERIOD ENDING 1/7/70	NEXT PERIOD ENDING 1/14/70

STEP 1

DEPOSITS AND VAULT CASH - BASE PERIOD FROM December 18, 1969 TO December 24, 1969

LINE	DATE	DAY	GROSS DEMAND DEPOSITS: DEPOSITS OF BANKS	GROSS DEMAND DEPOSITS: U.S. GOV'T DEMAND DEPOSITS	GROSS DEMAND DEPOSITS: OTHER DEMAND DEPOSITS	DEDUCTIONS ALLOWED IN COMPUTING RESERVES: CASH ITEMS IN PROCESS OF COLLECTION	DEDUCTIONS ALLOWED IN COMPUTING RESERVES: DEMAND BALANCES DUE FROM BANKS	NET DEMAND DEPOSITS COL. 1 & 2 & 3 MINUS 4 & 5	SAVINGS AND CLUB DEPOSITS	OTHER TIME DEPOSITS	CURRENCY AND COIN (NET OF CASH IN TRANSIT TO - FROM FEDERAL RESERVE BANK)
			BALANCES AT CLOSE OF BUSINESS								
			1	2	3	4	5	6	7	8	9
			MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS	MILL. THOUS
1	18	THUR	1 860	1 880	26 050	2 360	3 630	23 800	8 040	3 200	2 110
2	19	FRI.	1 900	1 870	26 210	2 010	3 480	24 490	7 890	3 350	1 880
3	20	SAT.	1 900	1 870	26 210	2 010	3 480	24 490	7 890	3 350	1 880
4	21	SUN.	1 900	1 870	26 210	2 010	3 480	24 490	7 890	3 350	1 880
5	22	MON.	1 900	1 870	26 210	2 010	3 480	24 490	7 890	3 350	1 880
6	23	TUES.	1 800	1 290	26 605	2 920	3 380	23 395	8 100	3 220	2 300
7	24	WED.	1 580	1 200	26 746	2 540	3 220	23 766	8 350	2 970	2 290
8		PERIOD TOTALS	12 840	11 850	184 241	15 860	24 150	168 921	56 050	22 790	14 220
9		ROUND TO THE NEAREST THOUSAND WHEN DIVIDING THE TOTALS FROM COLUMNS 6, 7, 8 & 9 BY SEVEN TO OBTAIN DAILY AVERAGES					DAILY AVERAGES	24 132	8 007	3 256	2 031

STEP 2

RESERVE REQUIREMENT FOR CURRENT PERIOD 3

LINE		NET DEMAND DEPOSITS UP TO* $5 Million	NET DEMAND DEPOSITS OVER* $5 Million		SAVINGS AND CLUB DEPOSITS*	OTHER TIME DEPOSITS UP TO* $5 Million	OTHER TIME DEPOSITS OVER* $5 Million
		10	11	12	13	14	15
		MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H
10	DEPOSIT AVERAGES (FROM STEP 1, LINE 9)	5 000 0	19 131 6		8 007 0	3 256 0	-
11	RESERVE PERCENTAGES*	(X) 12½ %	(X) 13 %	(X) %	(X) 3 %	(X) 3 %	X 6
		MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H	MILL. THOUS H
12	AVE REQUIRED RESERVES (LINE 10 X LINE 11)	625 0	2 487 1		240 2	97 7	
13	TOTAL AVERAGE REQUIRED RESERVE (ACCUMULATE AMOUNTS ON LINE 12)						3 450 0
14	LESS: AVERAGE CURRENCY AND COIN (FROM STEP 1 COLUMN 9 LINE 9)						2 031 0
15	AVERAGE NET REQUIRED RESERVE (NET OF LINES 13 AND 14) (CHECK TO RELATED FORM B-89, COLUMN 17)						1 419 0

*USE DEPOSIT BASES AND RESERVE PERCENTAGES PRESCRIBED IN CURRENT SUPPLEMENT TO REGULATION D

STEP 3

COMPUTATION OF CUMULATIVE RESERVE POSITION

RESERVE PERIOD FROM January 1, 1970 TO January 7, 1970 CURRENT PERIOD 3

LINE																									
16	CARRY OVER FROM PRIOR PERIOD 2, (USE ESTIMATE UNTIL RECEIPT OF B-89A (ITEM G) ON FRIDAY OR MONDAY)																						0		
17	DAILY AVERAGE RESERVE BALANCE NEEDED AT F.R.B. (LINE 15 PLUS DEFICIENCY OR MINUS EXCESS FROM LINE 16)																						1 419	0	
	COMPUTE DAILY BEGINNING THURSDAY OF RESERVE WEEK (SEE INSTRUCTIONS FOR LINES 18 & 21)	16			17			18			19			20											
		Date Jan. 1			Date Jan. 2-3-4			Date Jan. 5			Date Jan. 6			Date Jan. 7											
		THURS			FRI. SAT. SUN.			MON.			TUES.			WED.											
		MILL.	THOUS	H	MILL.	THOUS	H	MILL.	THOUS	H	MILL.	THOUS	H	MILL.	THOUS	H									
18	RESERVE BALANCE FROM DAILY FEDERAL RESERVE STATEMENT	1	527	6	5	080	8	1	308	2	1	253	5	1	499	8									
19	NET "AS OF" ADJUSTMENTS (SEE DETAILED INSTRUCTIONS)		-			-			-			-			-										
20	TOTAL RESERVE AVAILABLE (NET OF LINES 18 & 19)	1	527	6	5	080	8	1	308	2	1	253	5	1	499	8									
21	DAILY AVERAGE RESERVE BALANCE NEEDED AT FEDERAL RESERVE BANK (FROM LINE 17)	1	419	0	4	257	0	1	419	0	1	419	0	1	419	0									
22	DAILY EXCESS OR DEFICIENCY (NET OF LINES 20 & 21)	+	108	6	+	823	8	-	110	8	-	165	5	+	80	8									
23	CUMULATIVE EXCESS OR DEFICIENCY (ACCUM. AMOUNTS ON LINE 22)	+	108	6	+	932	4	+	821	6	+	656	1	+	736	9	**								

**Divide by 7 to compare with Item H shown on Reserve Computation Statement, Form B-89A, which should reach member banks on Friday or Monday of each week. ** $105,400 per day

Column 3 - Should include all demand deposits of individuals, partnerships, corporations, city and town - treasurers, Federal credit unions and cooperative banks.

Allowable Deductions from Gross Demand Deposits

Column 4 - Deduct cash items in process of collection, i.e., checks forwarded to the Federal Reserve Bank for collection or checks forwarded to your city correspondent, redeemed U.S. Savings Bonds, other U.S. securities, corporate and municipal bonds or any other item your bank has redeemed.

Column 5 - Deduct balances subject to immediate withdrawal - due from banks, i.e., funds your bank has on deposit with correspondents. Obviously you should exclude balances at the Federal Reserve Bank.

Column 6 - Net demand deposits. This is a computed entry which is made up of the total of columns 1, 2, and 3, minus the total of columns 4 and 5.

Savings and Other Time Deposits

Column 7 - Should include all savings deposits of individuals or corporations not operated for a profit, savings of trust funds or school districts, and Christmas and vacation clubs.

Column 8 - Should include time certificates of deposit, other time deposits of individuals, corporations, partnerships and trust funds. Also included should be deposits of states and political subdivisions and commercial banks.

Column 9 - Should include currency and coin held in banks' own vaults plus cash in transit to and from the Federal Reserve Bank.

Depending upon policy of top management, the person handling the money position should study the bank's position closely so that he keeps all available excess funds employed at the best rate offered in the money market, or should he have a cumulative deficiency, action should be taken to eliminate the deficiency. In the event of a deficiency, a bank may transfer funds from its correspondent, buy

Federal Funds, sell Treasury Bills, borrow at the Federal Reserve Bank, or use some other quick method of securing funds. In the event of a cumulative excess, several alternatives are available, i.e., sell Federal Reserve Funds, buy U.S. Treasury Bills, offer repurchase agreements, etc. Money market instruments will be discussed in detail in a subsequent chapter.

Excess Reserves

Excess reserves of a member bank are the amount by which average daily reserves maintained exceed required reserves during a weekly period. Inasmuch as they are nonearning assets, it has become increasingly important in the high interest rate climate of recent years for a member bank to keep excess reserves at a minimum. This is accomplished first by closely following the cumulative reserve position during each weekly period and second by adjusting assets and liabilities to hold excess reserves to the lowest feasible minimum working balances. Some banks are more efficient than others in the management of their reserve positions and, generally, the large and medium size banks are able to follow their reserve balances more closely than the smaller banks. Approximate average percentage ratios of excess reserves to required reserves for country member banks in the First Federal Reserve District are as follows:

Total Deposits	*Percent of Excess Reserves*
Over $100 million	1.43%
$50 million to $100 million	1.38%
$25 million to $50 million	1.21%
$10 million to $25 million	2.42%
Under $10 million	21.90%

In evaluating the significance of the foregoing ratios, it is important to keep in mind that an excess of $10,000 will constitute only a fraction of 1% of the required reserve of a large bank while it will constitute a substantial portion of the total required reserve of a very small bank.

For a number of years, the Federal Reserve Bank of Boston has endeavored to guide its smaller banks along the lines of holding excess reserves to a reasonable minimum. This program has included presentations at the functional cost seminars, discussions by bank relations representatives during their visits to individual banks and, in some cases, suggestions made in the process of administering the discount window when the figures disclosed that a bank was borrowing substantially more than it needed with the result that it was running high excess reserve balances. The Reserve Bank has provided instructions and advice on computing the cumulative position during a weekly reserve period, has suggested appropriate outlets for employment of short-term excess funds such as the Federal Funds market or U.S. Treasury Bills, and has acquainted many banks with its service of placing orders with dealers for the purchase or sale of U.S. Government and Agency securities at the best market price. The latter service will be discussed in more detail in a later chapter.

Monetary Policy and Bank Reserves

The Federal Reserve System, under leadership of the Federal Reserve Board of Governors, uses three basic tools in effecting monetary policy: open market operations, reserve requirements, and the discount rate.

The System's most important policy-making body is the Federal Open Market Committee, composed of the Board of Governors, the president of the New York Reserve Bank, and four other Reserve Bank presidents in annual rotation. The Committee meets regularly to review national economic developments and to determine monetary policy, particularly open market operations - the System's purchases and sales of government securities in the nation's securities market, centered in New York City.

The daily action of the desk at the Open Market Account in New York can significantly influence the flow of bank reserves. The desk implements the monetary policy set forth by the System Open Market Committee. Open market operations are conducted on a daily basis and can create reserves through purchases or absorb reserves from the system by sales of government securities under policy directive of the Open Market Committee. For example, the Federal Reserve System, through the trading desk at the Federal

FEDERAL FUNDS

OPEN	HIGH	LOW	CLOSE
8 1/2	12	7 1/2	12

DISCOUNT RATE - FRB of Boston - Effective April 8, 1969.....6%

PRIME RATE - Effective June 9, 1969.....8 1/2%

DEALERS RATE - For borrowing on U. S. Government Securities.....9 1/4 - 9 1/2%

YIELDS ON - 90-day Treasury Bills - offered price.....7.88%

RATES ON - Dealer - Commercial Paper - 4 to 6 months.....8 1/2 - 9%

		Bid	Offer
RATES ON - Bankers Acceptances -	30 to 90 days	8 1/2%	8 3/8%
	91 to 120 days	8 5/8%	8 3/4%

RATES ON - Certificates of Deposit - 3 months.....8 7/8%
(Secondary market) 6 months.....9%

NEW YORK MONEY MARKET RATES, WEDNESDAY, FEBRUARY 4, 1970

Illustration C

DAILY QUOTATION - NEW YORK MONEY MARKET RATES

Reserve Bank of New York, might buy for the Open Market Account $1 million of Treasury Bills from a government securities dealer in New York. The Federal Reserve Bank pays for the securities with a check issued on itself. The dealer deposits this check in his account with a commercial bank, which sends it for collection and immediate credit to its reserve account at the Federal Reserve Bank of New York.

The Federal Reserve System has added $1 million dollars of securities to its assets, which it has paid for, in effect, by creating member bank reserves. On the commercial bank's book, these reserves are matched by $1 million of additional demand deposits (money) which did not exist before the transactions.

Another Federal Reserve tool for releasing or absorbing reserves is the authority to change reserve requirements. As indicated earlier, the Federal Reserve Board determines from time to time what appropriate reserve requirements should be, and their action can either release or absorb bank reserves. However, required reserves are infrequently changed.

Finally, the borrowing or repayment of borrowing at the discount window creates or absorbs reserves; but it should be noted that this reserve-creating facility is used only at the initiative of individual member banks.

Apart from the foregoing reserve-creating tools of the Federal Reserve System, reserves are also created or absorbed by fluctuations in Federal Reserve float,[1] Treasury operations, currency outstanding, and gold flows through the international payments mechanism.

[1]Float results because the Federal Reserve gives credit to member banks for some checks sent for collection before the Fed collects them.

CHAPTER III

FEDERAL RESERVE FUNDS

Description of Federal Reserve Funds

Federal Funds are immediately available reserve balances at the Federal Reserve Banks. For a number of years, and in increasing volume and importance in the past nine years, the large city member banks have traded Federal Funds as a means whereby a member bank with temporary excess reserves may sell them (which is actually a loan) as a means of earning interest on such excess balances, and a member bank with a temporary deficiency in required reserves may buy such balances (actually a borrowing). Sales of Federal Funds are essentially unsecured loans made by one member bank to another member bank. The usual Federal Funds sale is for overnight or if sold on Friday - over the weekend - for three days. The Federal Funds rate is generally determined by the day's trading centered in the New York City money market banks. Prior to 1965, Funds usually traded at a rate less than, or equal to, the Federal Reserve discount rate. Prior to 1965, the Federal Funds market was a more simple and quite often a lower cost alternative to borrowing from the Federal Reserve Bank. Even when the Federal Funds rate is above the discount rate, as has generally been the case since late 1964, many banks prefer to buy Funds rather than visit the Federal Reserve discount window. Recently there has been a willingness of some banks to pay 4 percent above the discount rate for Federal Funds. The Federal Reserve System has never openly approved or disapproved of the use of the Federal Funds market as a reserve adjustment mechanism. Currently, however, the System might be said to approve informally the use of this market since it makes use of existing reserves and tends to bring about a redistribution of such funds. Unlike borrowing at the discount window or open market operations, no additional Federal Reserve Bank credit is created in Federal Funds transactions.

Selling banks on occasion prefer to use this market as an alternative to short-term investments in commercial paper, bankers' acceptances, brokers' loans, or Treasury Bills, if the outlook for short-term rates is uncertain.

The large city banks generally do not arrange transactions with one another but use a New York Federal Funds broker or another

intermediary in New York. Among the large city banks the common unit of trading is $1 million, although transactions are effected in blocks of $100,000 or more.

Types of Banks Authorized to do Federal Funds

Until early 1970, member banks were permitted to buy and sell Federal Funds with commercial banks (members and nonmembers), Government securities dealers, savings banks (mutual and stock), savings and loan associations, and any other firm, institution, or organization. All such transactions were exempt from the Board of Governors regulations.

On February 12, 1970, the Board of Governors of the Federal Reserve System amended its regulations to narrow the category of "Federal Funds" transactions that are exempted from its rule governing reserves of member banks (Regulation D) and payment of interest on deposits (Regulation Q). The main effect of the amendments has been to bring within the coverage of the regulations such transactions with any person, *other than a bank,* and its subsidiaries, various governmental institutions, or, in certain cases, a securities dealer. For the purpose of the exemption, a bank includes the following:

(a) A member commercial bank
(b) A nonmember commercial bank
(c) A savings bank
(d) A savings and loan association
(e) A cooperative bank
(f) An Export-Import bank
(g) A foreign bank

Some large city banks, including banks in New York, Boston, Philadelphia, Pittsburgh, Chicago, Dallas, San Francisco, Los Angeles, Detroit, Cleveland, and St. Louis, in addition to buying and selling Funds for their own requirements, provide or absorb Federal Funds as a service to their correspondent country banks and, in providing such services, may trade in blocks as small as $50,000. The smaller country banks in the First Federal Reserve District, when buying or selling Federal Funds, ordinarily go to their New York or Boston correspondent.

One of the large city banks[1] defines its function in Federal Funds as that of a clearing house since there are three methods by which it may handle transactions in Federal Funds:

(a) To the extent possible they will match on their books buy and sell orders, which they receive from correspondents.

(b) When their own reserve position is on the other side from that of its correspondent, it will care for the correspondent's needs out of its own position.

(c) When it is not possible to consummate transactions by means of (a) or (b), it will use its best efforts to cover their correspondent's needs in the national Federal Funds market.

Mechanics of Transactions in Federal Funds

Normally, the country bank arranges to purchase Federal Funds by telephone communication with its city correspondent. The selling bank advises the local Federal Reserve Bank by telephone, telegram, or teletype to charge its account and credit the buying bank. Letters of confirmation follow the telephone calls or telegrams to the Reserve Bank, and the buyer and seller exchange written confirmation. The entries are reversed the next day by the buying bank. Interest is paid by cashier's or treasurer's check or by credit to correspondent account. No promissory note is executed, as a Federal Funds transaction is an oral contract subject to written confirmation, although in most instances the city correspondent and its country bank customer sign an underlying agreement covering the terms and conditions whereby Federal Funds transactions will be effected.

Many country banks may arrange to sell Federal Funds to their city correspondent bank. For such transactions, the mechanics are the same as described above for purchases with the roles of seller and buyer reversed.

[1] First National Bank of Boston letter dated November 1961.

Legal Limits

Until July of 1963, the restriction imposed on national banks (and there were similar provisions in many states' statutes) *that aggregate borrowing* (except borrowing from the Federal Reserve Bank) could not exceed 100 percent of capital stock and 50 percent of surplus was a limiting factor in purchase of Federal Funds. When a national bank was selling Federal Funds on an unsecured basis, it had to consider that such sales were loans and they came under the single borrower limitation for unsecured loans in the National Bank Act (similar limitations still exist in many states' statutes) and thus limited in individual transactions to 10 percent of capital and surplus of the selling bank. However, under a 1958 regulation issued by the Comptroller of the Currency, there was no limitation against the selling bank provided the bank buying Federal Funds secured its purchases with United States Government securities maturing not more than 18 months from the date of the Fund transaction.

In its "Manual for National Banks," published in June 1963, the Comptroller of the Currency issued the following ruling under "Lending Limits," Section 1130, "Sale of Federal Reserve Funds to Another Bank:"

> "When a bank purchases Federal Reserve Funds from another bank, the transaction ordinarily takes the form of a transfer from a seller's account in the Federal Reserve Bank to the buyer's account therein, payment to be made by the purchaser, usually with a specified fee. The transaction does not create on the part of the buyer an obligation subject to the lending limit or a borrowing subject to 12 U.S.C. 82, but is to be considered a purchase and sale of such funds."

The foregoing ruling has been interpreted to mean that in the opinion of the Comptroller of the Currency there is no legal limit to the amount a national bank may buy or sell in the Federal Funds market.

However, it continues to be the position of the Board of Governors that, for purposes of provisions of law administered by the Board, a transaction in Federal Funds involves a loan on the part

of the "selling" bank and a borrowing on the part of the "purchasing" bank.

It is estimated that Federal Funds purchased by member banks in the year 1969 in the First Federal Reserve District on a daily average amounted to $600 million, while the average for the United States was about $4.5 billion.

CHAPTER IV

REPURCHASE AGREEMENTS OR "BUY BACKS"

Agreements with Dealers

The United States Government securities market is one of the key financial markets in this country. Practically all of the transactions in this market are effected through a group of dealers who make markets by buying and selling securities for their own account. For such a market to function effectively, dealers must be willing and able to maintain sizeable inventories of securities to accommodate customers in situations where there are no immediate offsetting transactions. Since the nonbank dealers' positions are carried largely on borrowed funds, the cost of financing is a major consideration. The search for relatively cheap sources of financing is a key factor on a day-to-day basis. The most common method of borrowing by the nonbank dealer is through a "repurchase agreement" with money market banks, other banks, insurance companies, or large corporations.

A "repurchase agreement" permits the employment of temporary funds overnight, for a specified number of days, or occasionally for a month or more, at a fixed rate of interest, without any risk of loss from market fluctuations in the securities involved. It is a simultaneous agreement (sometimes referred to as a "buy back") by the dealer to sell and subsequently repurchase, and by the investing bank to purchase and subsequently resell to the dealer specified securities, generally U.S. Government securities with maturities not in excess of 18 months.

To cite a typical transaction, in response to a dealer's inquiry, a bank might offer to buy a certain amount of securities at a stated price and an agreed rate, usually based on money market rates prevailing that day including the Federal Funds rate, dealer loan rates and, to a lesser extent, the rate on short-term Treasury Bills. Generally, the price is determined by the bid side of the market. The securities are delivered to the investing bank or its designated depository (usually a New York city bank) against payment and

subject to simultaneous agreement to resell the same securities to the dealer with redelivery and payment to be made on the maturity date of the repurchase contract. The selling dealer reserves the right to exchange the securities for comparable market issues throughout the term of the agreement. All purchases and sales are consummated in Federal Reserve funds at the termination of the agreement, and the investing bank receives an interest payment for the number of days it has held the securities. At the time the repurchase transaction is arranged, the buying bank receives two confirmation tickets - one covering the initial purchase of the securities and the other the repurchase by the dealer. These confirmation tickets indicate pertinent data on the transaction including the price, the delivery date and the interest rate. During the term of the agreement, the bank, in addition to holding the securities, as further protection holds the repurchase contract of the securities dealer.

Another method by which dealers may finance their inventory positions is to borrow at call from a New York money market bank with securities pledged as collateral.

Finally, the Federal Reserve Bank of New York may provide dealer financing through repurchase agreements if it is deemed desirable in conjunction with the Fed's open market operations and conditions in the money market at that time.

Agreements with Bank Customers

As a source of funds to member banks on the one hand and, on the other, as a means to bank customers of deriving a higher income than permitted on deposits of less than 30 days, many banks have entered into repurchase agreements with their customers. Repurchase agreements of this nature are restricted to direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof. The bank's customer would probably indicate he has funds to invest at a competitive rate for a relatively short period of time. By letter, the selling bank would confirm to its customer a complete description of the transactions, i.e. par amount, rate and maturity, and the confirmation of the repurchase at a future date. The number of days, rate and total earnings would also be indicated in the letter. A nonnegotiable

safekeeping receipt would be attached and addressed to the buyer, signed by an authorized official of the selling bank. The safekeeping receipt would indicate whether the bonds were held at the Federal Reserve Bank under book entry or held in the vault of the selling bank. These repurchase agreements have proven to be most beneficial to banks' customers, as they have been a means of employing funds for periods of from 5 to 30 days or longer at higher rates than those permitted under the provisions of the Federal Reserve's Regulation Q. They have also been another source of funds to the banks during the money "crunch" of 1969.

REPURCHASE AGREEMENT — Illustration D

DOLLAR NATIONAL BANK
QUINCY, VERMONT

February 2, 1970

Mr. Roger W. Brown
Rockwell Lumber Company
Rockwell, Vermont 02295

Dear Mr. Brown:

In accordance with your instructions we confirm having sold you

100,000. U. S. Treasury Notes 5% due November 15, 1970
owned by this bank at par flat for delivery and payment on

February 2, 1970.

The securities will be held by us in safekeeping for your account. We enclose our Safekeeping Receipt No. 986555.

We also confirm the purchase from you of the above securities for delivery and payment on February 17, 1970. At that time we will remove the securities from safekeeping and credit your account for the above amount plus interest or forward our Cashier's Check at your request.

The effect of this transaction will be earnings of $ 328.77 for the period February 2 to February 17 which represents 8 % per annum on the amount invested for 15 days.

We appreciate the opportunity to be of service.

Very truly yours,

Alexander W. McDonald

Alexander W. McDonald
Vice President

jj

SAFEKEEPING RECEIPT-REPURCHASE AGREEMENT – Illustration E

NON NEGOTIABLE SAFEKEEPING RECEIPT NO. 986555

DATE: February 2, 1970

To: Rockwell Lumber Company
Rockwell, Vermont 02295

Face Amount	Description	Certificate or Bond Nos.
$100,000	Treas. Notes 5% due 11/15/70	FRB BE # 320008

In accordance with your instructions these items have been placed in safekeeping for your account.

Alexander J. McDonald
Authorized Signature

Vice President
Title

CHAPTER V

SECONDARY RESERVES

The assets known as secondary reserves are short-term government securities, bankers' acceptances, commercial paper, brokers' loans, negotiable certificates of deposit, and any other liquid asset that may readily be converted into cash.

Description of Treasury Obligations

With reference to U.S. Government securities, there are four different classifications: Treasury Bills, certificates of indebtedness, Treasury Notes, and Treasury Bonds. Treasury Bills are issued on a discount basis, and the rates are set by investors who tender bids for the securities. Ordinarily, they run for three, six, nine, or twelve months, except for special issues such as tax anticipation issues that may run from 150 to 200 days. Bills are bought by banking institutions for very short-term investments to take care of unexpected rises in deposits that may remain on deposit for an indefinite length of time or to invest short-term funds for a definite period of time. Certificates of indebtedness[1] are issued for periods of up to one year. Unlike bills, they have coupons attached which specify a fixed rate of return. Their investment purpose is not too different from that of Treasury Bills except that banks may buy them for specific needs such as Christmas Clubs, Vacation Clubs, mortgage tax accumulation, etc. Notes and bonds are very similar, both having coupons attached. About the only difference is that notes have a one- to seven-year maturity, and bonds may run as high as 35 years or more. Government securities are the most marketable of any security and can be sold for "cash delivery" the same day.

Purchase and Sale of Treasury Bills

In their modern form, U.S. Treasury Bills were first offered in 1929. The first issue, for $100 million, was sold in December 1929 and had a maturity of 90 days.

New offerings of three- and six-month bills are made each week by the Treasury. Ordinarily subscriptions or bids are invited on

[1]None outstanding at the present time.

159836A

1000000

THE UNITED STATES OF AMERICA

1000000

TREASURY BILL

TREASURY DEPARTMENT
WASHINGTON

ON PRESENTATION OF THIS TREASURY BILL TO THE TREASURER OF THE UNITED STATES OR TO ANY FEDERAL RESERVE BANK THE UNITED STATES OF AMERICA WILL PAY TO THE BEARER

ONE MILLION DOLLARS

WITHOUT INTEREST ON THE DUE DATE HEREON SPECIFIED. THIS TREASURY BILL IS ISSUED UNDER AUTHORITY OF THE SECOND LIBERTY BOND ACT, AS AMENDED, IN ACCORDANCE WITH, AND SUBJECT TO, THE PROVISIONS OF TREASURY DEPARTMENT CIRCULAR NO. 418, REVISED, TO WHICH REFERENCE IS MADE FOR A STATEMENT OF THE RIGHTS OF HOLDERS, AS FULLY AND WITH THE SAME EFFECT AS THOUGH HEREIN SET FORTH. THIS TREASURY BILL IS ISSUED BY A FEDERAL RESERVE BANK OR BRANCH PURSUANT TO A TENDER ACCEPTED BY THE SECRETARY OF THE TREASURY. IT SHALL NOT BE VALID UNLESS THE ISSUE DATE AND THE MATURITY DATE ARE ENTERED HEREON.

ISSUE DATE
MAY 22, 1969

DUE
AND
PAYABLE
NOV. 20 1969

David M. Kennedy
SECRETARY OF THE TREASURY

THE UNITED STATES OF AMERICA

FOR VALUE RECEIVED PROMISES TO PAY TO THE BEARER THE SUM OF

TEN THOUSAND DOLLARS 22293

ON MAY 15, 1976, AND TO PAY INTEREST ON THE PRINCIPAL SUM FROM THE DATE HEREOF, AT THE RATE OF SIX AND ONE-HALF PERCENT PER ANNUM, PAYABLE SEMIANNUALLY ON NOVEMBER 15, 1969, AND THEREAFTER ON MAY 15 AND NOVEMBER 15 IN EACH YEAR UNTIL THE PRINCIPAL AMOUNT BECOMES PAYABLE, UPON PRESENTATION AND SURRENDER OF THE INTEREST COUPONS HERETO ATTACHED AS THEY SEVERALLY MATURE, AT THE TREASURY DEPARTMENT, WASHINGTON, D. C., OR, AT THE HOLDER'S OPTION, AT ANY AGENCY OR AGENCIES IN THE UNITED STATES WHICH THE SECRETARY OF THE TREASURY MAY FROM TIME TO TIME DESIGNATE FOR THE PURPOSE. THIS NOTE IS ONE OF A SERIES OF NOTES OF THE UNITED STATES, AUTHORIZED BY THE SECOND LIBERTY BOND ACT, AS AMENDED, ISSUED PURSUANT TO TREASURY DEPARTMENT CIRCULAR, PUBLIC DEBT SERIES—No. 4-69, DATED MAY 1, 1969, AND DESIGNATED 6½ PERCENT TREASURY NOTES OF SERIES B-1976, AND IS NOT SUBJECT TO CALL FOR REDEMPTION PRIOR TO MATURITY. THE INCOME DERIVED FROM THIS NOTE IS SUBJECT TO FEDERAL TAXES IMPOSED UNDER THE INTERNAL REVENUE CODE OF 1954. THIS NOTE IS SUBJECT TO ESTATE, INHERITANCE, GIFT OR OTHER EXCISE TAXES, WHETHER FEDERAL OR STATE, BUT IS EXEMPT FROM ALL TAXATION NOW OR HEREAFTER IMPOSED ON THE PRINCIPAL OR INTEREST HEREOF BY ANY STATE, OR ANY OF THE POSSESSIONS OF THE UNITED STATES, OR BY ANY LOCAL TAXING AUTHORITY. IT IS ACCEPTABLE TO SECURE DEPOSITS OF PUBLIC MONEYS. IT IS NOT ACCEPTABLE IN PAYMENT OF TAXES.

WASHINGTON, D. C., MAY 15, 1969.

SECRETARY OF THE TREASURY

6½% TREASURY NOTE

SERIES B-1976

DATED MAY 15, 1969

DUE MAY 15, 1976

INTEREST PAYABLE MAY 15 AND NOVEMBER 15

THE UNITED STATES OF AMERICA

WILL PAY TO BEARER ON AT THE TREASURY DEPARTMENT WASHINGTON, OR AT A DESIGNATED AGENCY. NOV. 15, 1975

Three Hundred Twenty-five Dollars $325.00

BEING INTEREST THEN DUE ON

$10,000 6½% Treasury Note, Series B-1976

22293 13

THE UNITED STATES OF AMERICA

WILL PAY TO BEARER ON AT THE TREASURY DEPARTMENT WASHINGTON OR AT A DESIGNATED AGENCY MAY 15, 1976

Three Hundred Twenty-five Dollars $325.00

BEING INTEREST THEN DUE ON

$10,000 6½% Treasury Note, Series B-1976

22293 14

THE UNITED STATES OF AMERICA

WILL PAY TO BEARER ON AT THE TREASURY DEPARTMENT WASHINGTON NOV. 15, 1976

THE UNITED STATES OF AMERICA

WILL PAY TO BEARER ON AT THE TREASURY MAY 15, 1977

Thursdays, and the amounts of the offerings are set at that time. The auction is usually conducted on the following Monday, with delivery and payment on the following Thursday.

Bids or tenders in the weekly auctions must be presented at Federal Reserve Banks or their branches, which act as agents for the Treasury, by 1:30 p.m., New York time, on the day of the auction. Bids may be on a competitive or a noncompetitive basis. Competitive bids are usually made by large investors who are in close contact with the market. (The dealers are a major factor in the bidding.) These bids comprise the largest portion of subscriptions on a dollar basis. In this type of tender the investor states the quantity of bills desired and the price he is willing to pay. A subscriber may enter more than one bid indicating the various quantities he is willing to take at different prices. Individuals and other small investors usually enter noncompetitive bids, which are awarded in full up to $200,000 on both the 91-day and the 182-day bills. Noncompetitive awards are sold at the average price of accepted competitive bids.

Subscription books at the various Federal Reserve Banks and branches close promptly at 1:30 p.m.; and the bids are then opened, tabulated, and submitted to the Treasury for allocation. The Treasury first makes all noncompetitive awards. The remainder is then allocated to those competitive bidders submitting the highest offers, ranging downward from the highest bid until the amount offered is allocated. The "stop-out price" *is the lowest price, or highest yield,* at which bills are awarded. Usually only a portion of the total bids made at this price is accepted. The average issuing price, which is usually closer to the lowest accepted price than to the highest, is then computed on the basis of the competitive bids accepted.

Dealers in government securities provide a market for Treasury Bills in which purchases and sales are made at net prices expressed in terms of yield. Because of ready marketability and the relatively low spread between bid and asked prices, Treasury Bills usually may be sold without loss after being held for three to five days. For this reason commercial banks utilize them for the purpose of effecting adjustments in the money position.

Treasury Bills are issued in denominations of $10,000; $50,000; $100,000; $500,000; and $1,000,000. The Internal Revenue Code

UNITED STATES TREASURY BOND 3½% – Illustration H

3½%
TREASURY BOND
OF 1998
DATED OCTOBER 3, 1960
DUE NOVEMBER 15, 1998

1601

THE UNITED STATES OF AMERICA

FOR VALUE RECEIVED PROMISES TO PAY TO THE BEARER THE SUM OF

ONE HUNDRED THOUSAND DOLLARS

ON NOVEMBER 15, 1998, AND TO PAY INTEREST ON THE PRINCIPAL SUM FROM THE DATE HEREOF, AT THE RATE OF THREE AND ONE-HALF PERCENT PER ANNUM, PAYABLE ON A SEMIANNUAL BASIS ON MAY 15 AND NOVEMBER 15, 1961, AND THEREAFTER ON MAY 15 AND NOVEMBER 15 IN EACH YEAR UNTIL THE PRINCIPAL HEREOF SHALL BE PAYABLE; UPON PRESENTATION AND SURRENDER OF THE INTEREST COUPONS HERETO ATTACHED AS THEY SEVERALLY MATURE, AT THE TREASURY DEPARTMENT, WASHINGTON, D. C., OR, AT THE HOLDER'S OPTION, AT ANY AGENCY OR AGENCIES IN THE UNITED STATES WHICH THE SECRETARY OF THE TREASURY MAY FROM TIME TO TIME DESIGNATE FOR THE PURPOSE. THIS BOND IS ONE OF A SERIES OF BONDS OF THE UNITED STATES, AUTHORIZED BY THE SECOND LIBERTY BOND ACT, AS AMENDED, ISSUED PURSUANT TO AND SUBJECT TO THE TERMS AND CONDITIONS OF TREASURY DEPARTMENT CIRCULAR No. 1055, DATED SEPTEMBER 27, 1960, AND DESIGNATED 3½ PERCENT TREASURY BONDS OF 1998. THIS BOND IS NOT SUBJECT TO CALL FOR REDEMPTION PRIOR TO MATURITY. THE INCOME DERIVED FROM THIS BOND IS SUBJECT TO ALL TAXES IMPOSED UNDER THE INTERNAL REVENUE CODE OF 1954. THIS BOND IS SUBJECT TO ESTATE, INHERITANCE, GIFT OR OTHER EXCISE TAXES, WHETHER FEDERAL OR STATE, BUT IS EXEMPT FROM ALL TAXATION NOW OR HEREAFTER IMPOSED ON THE PRINCIPAL OR INTEREST HEREOF BY ANY STATE, OR ANY OF THE POSSESSIONS OF THE UNITED STATES, OR BY ANY LOCAL TAXING AUTHORITY. THIS BOND, UPON THE DEATH OF THE OWNER, WILL BE REDEEMED AT THE OPTION OF THE DULY CONSTITUTED REPRESENTATIVES OF THE DECEASED OWNER'S ESTATE, AT PAR AND ACCRUED INTEREST, IF IT CONSTITUTES PART OF SUCH ESTATE AND THE PROCEEDS ARE TO BE APPLIED TO THE PAYMENT OF FEDERAL ESTATE TAXES, AS IN SAID CIRCULAR PROVIDED. THIS BOND IS ACCEPTABLE TO SECURE DEPOSITS OF PUBLIC MONEYS. THIS BOND IS SUBJECT TO THE GENERAL REGULATIONS OF THE TREASURY DEPARTMENT WITH RESPECT TO UNITED STATES BONDS.

WASHINGTON, D. C., OCTOBER 3, 1960.

SECRETARY OF THE TREASURY

100,000 ONE HUNDRED THOUSAND DOLLARS 100,000

THE UNITED STATES OF AMERICA
WILL PAY TO BEARER ON
AT THE TREASURY DEPARTMENT, WASHINGTON, OR AT A DESIGNATED AGENCY, NOV. 15, 1990
BEING INTEREST THEN DUE ON $1,750.00
$100,000 3½% Treasury Bond of 1998
1601 60

THE UNITED STATES OF AMERICA
WILL PAY TO BEARER ON
AT THE TREASURY DEPARTMENT, WASHINGTON, OR AT A DESIGNATED AGENCY, NOV. 15, 1994
BEING INTEREST THEN DUE ON $1,750.00
$100,000 3½% Treasury Bond of 1998
1601 68

THE UNITED STATES OF AMERICA
WILL PAY TO BEARER ON
AT THE TREASURY DEPARTMENT, WASHINGTON, OR AT A DESIGNATED AGENCY, NOV. 15, 1998
BEING INTEREST THEN DUE ON $1,750.00
$100,000 3½% Treasury Bond of 1998
1601 76

THE UNITED STATES OF AMERICA

THE UNITED STATES OF AMERICA

THE UNITED STATES OF AMERICA

DATED OCTOBER 30, 1960 DUE NOVEMBER 15, 1998

TWELVE FEDERAL LAND BANKS BOND 3½% — Illustration I

THE TWELVE FEDERAL LAND BANKS

WILL PAY TO BEARER ON AT ANY FEDERAL LAND BANK OR AT A DESIGNATED AGENCY, BEING SIX MONTHS INTEREST THEN DUE ON

APRIL 1, 1970

$17.50

$1,000 3½% Consolidated Bond of 1970

R. B. Tootell GOVERNOR 24

8595E

THE TWELVE FEDERAL LAND BANKS

WILL PAY TO BEARER ON AT ANY FEDERAL LAND BANK OR AT A DESIGNATED AGENCY, BEING SIX MONTHS INTEREST THEN DUE ON

OCT. 1, 1969

$17.50

$1,000 3½% Consolidated Bond of 1970

R. B. Tootell GOVERNOR 23

8595E

CONSOLIDATED FEDERAL FARM LOAN BOND

3½% BOND OF 1970
DATED FEBRUARY 14, 1958
DUE APRIL 1, 1970

8595E

1000 1000

THE TWELVE FEDERAL LAND BANKS

ORGANIZED AND EXISTING PURSUANT TO THE PROVISIONS OF THE ACT OF CONGRESS APPROVED JULY 17, 1916, AND ACTS AMENDATORY THERETO,

FOR VALUE RECEIVED JOINTLY AND SEVERALLY PROMISE TO PAY TO THE BEARER THE SUM OF

ONE THOUSAND DOLLARS

ON APRIL 1, 1970, WITH INTEREST ON SAID PRINCIPAL SUM AT THE RATE OF 3½ PER CENTUM PER ANNUM, PAYABLE ON OCTOBER 1, 1958, AND THEREAFTER SEMIANNUALLY, BUT ONLY UPON PRESENTATION AND SURRENDER OF THE INTEREST COUPONS HERETO ATTACHED AS THEY SEVERALLY MATURE. THE SAID PRINCIPAL AND INTEREST SHALL BE PAYABLE AT ANY FEDERAL LAND BANK, AT ANY FEDERAL RESERVE BANK OR BRANCH THEREOF OR AT SUCH OTHER AGENCY OR AGENCIES AS THE TWELVE FEDERAL LAND BANKS MAY DESIGNATE FROM TIME TO TIME. THIS BOND IS NOT SUBJECT TO CALL FOR REDEMPTION PRIOR TO MATURITY.

THE UNDERSIGNED GOVERNOR OF THE FARM CREDIT ADMINISTRATION HEREBY CERTIFIES THAT THIS BOND IS ISSUED UNDER THE AUTHORITY OF TITLE I OF THE FEDERAL FARM LOAN ACT; THAT IT HAS THE APPROVAL IN FORM AND ISSUE OF THE FARM CREDIT ADMINISTRATION; THAT IT IS LEGAL AND REGULAR IN ALL RESPECTS; THAT IT AND THE INCOME DERIVED THEREFROM ARE EXEMPT FROM STATE, MUNICIPAL, AND LOCAL TAXATION; THAT INTEREST ON THIS BOND IS NOT EXEMPT FROM TAXATION BY THE UNITED STATES GOVERNMENT, AND NEITHER IT NOR FROM THE SALE OR OTHER DISPOSITION OF SAID BOND NOR TRANSFER THEREOF AS BY INHERITANCE OR GIFT, IS EXEMPT FROM FEDERAL OR STATE TAXATION; THAT IT IS ISSUED AGAINST COLLATERAL SECURITY PRESCRIBED BY THE FEDERAL FARM LOAN ACT, AS AMENDED, AT LEAST EQUAL IN AMOUNT TO THE BONDS ISSUED; AND THAT ALL FEDERAL LAND BANKS ARE LIABLE FOR THE PAYMENT OF THIS BOND.

IN WITNESS WHEREOF THIS BOND HAS BEEN SIGNED BY THE GOVERNOR OF THE FARM CREDIT ADMINISTRATION, ATTESTED BY A DEPUTY GOVERNOR AND THE SEAL OF THE FARM CREDIT ADMINISTRATION HEREUNTO AFFIXED.

ATTEST: DEPUTY GOVERNOR

R. B. Tootell GOVERNOR

1000 1000

DATED FEBRUARY 14, 1958 DUE APRIL 1, 1970

provides that Treasury Bills shall be excluded from consideration as capital assets, so that the difference between purchase price and sale price or maturity value is an ordinary gain or loss of interest income, not a capital gain.

As a service to its member banks, the Federal Reserve Bank of Boston will execute, as their agent, purchases and sales of marketable securities of the United States Government (including its agencies), with dealers in government securities. All purchases and sales are made "at the market" on the basis of telephone competitive bids, usually from three or more dealers. Ordinarily on the day of receipt of a purchase or sale request from a member bank, orders are placed for "regular" delivery on the next business day. In the event a bank has excess funds it wishes to employ immediately, the Federal Reserve will place orders for "cash delivery" and payment the same day, thereby increasing the member bank's earning assets immediately. If a bank finds itself in need of funds immediately, the Federal Reserve will sell securities for "cash delivery" and payment the same day, thereby putting the bank in immediately available funds. This affords a bank the opportunity to run a close reserve position, and country member banks have found this to be a very helpful and convenient service.

Commercial Paper

Commercial paper is the name applied to unsecured promissory notes issued by various companies of established financial stature to raise money for short periods of time. It has been a means of providing funds to American industry since the early 1800's, and has enjoyed its greatest growth in recent years. Totals outstanding have risen from less than $1 billion immediately after World War II to as high as $36 billion or more recently. During the past three years many corporate treasurers have experimented with this supplemental financing vehicle and have found it efficient and economical. Large numbers of medium-sized and large corporations are entering the commercial paper market for the first time. At the same time portfolio managers have found this paper unusually attractive and have been rather aggressive buyers of such paper. This type of note when due within 90 days is generally eligible for discount at the Federal Reserve Banks.

Many transactions in commercial paper are handled through commercial paper dealers - there is no direct contact between

COMMERCIAL PAPER — Illustration J

131-74

$100,000. Boston, Massachusetts (CITY AND STATE) January 28, 1970 (DATE)

On April 27, 1970 *we promise to pay to the order of*

BEARER

ONE HUNDRED THOUSAND DOLLARS

Payable at The Fifth National Bank of Boston, Massachusetts

Value Received.

David Manufacturing Corporation

~~XXXXXXXXXXXXXX~~

No. 729

T. Robin David President

AUTHORIZED SIGNATURE

borrower and lender. The dealer purchases the paper outright from the borrower at a flat rate plus a commission for handling the paper. The commission is usually 1/8 to 1/4 of 1 percent included in the net rate to the borrower or the maker of the note. The paper in turn is sold (at the going market rate) by the dealer on a discount basis. All commercial paper offered by dealers is in even figures such as $50,000; $100,000; and $500,000 notes. There are no odd or in-between amounts issued, and the most common denominations currently range from $100,000 to $1,000,000 and are generally sold for delivery and payment at a bank against payment in Federal Funds. The majority of the notes are made payable at a New York or Chicago bank.

Notes issued for $100,000 are used mainly for investment by small country banks as a means of splitting up the offering of borrowers who insist upon a wide distribution of paper through the country banks. The denominations in which paper is currently issued are determined largely by the dealer. He. generally suggests to the borrower the denomination to be issued, bearing in mind the size of the borrowing concerned, the amount currently being borrowed in the open market, the degree of distribution desired by the borrower, and the condition of the money market. Most of the paper sold in the open market today has a maturity of from three days to nine months. If it is longer, the issue must be registered with the Securities and Exchange Commission.

Dealers sometimes request the borrower to issue specific maturities to assist open market investors to provide some known or anticipated future demand for funds. The commercial paper market is organized so that once the concern has become a recognized issuer of paper, it can obtain funds with a minimum of formality and delay.

Some of the small sales finance companies still market their notes through dealers, but most of the larger companies now sell them directly to institutional investors, thereby creating a new market for themselves.

Commercial paper is bought for investment by industrial corporations, public utilities, educational institutions, trust funds, public funds, charities, hospitals, as well as by *banks,* insurance companies and other institutional investors.

At the present time there are only about 450 firms that are recognized as qualified issuers of commercial paper.

From an economic standpoint, commercial paper has proved its usefulness and reliability over many years and will continue to play an important part in serving industry, commerce and banking because of the advantageous features this technique offers both to the borrower and the investor.

For a national company to market its paper through dealers in the commercial paper market, it should be able to comply with the following requirements:

a. Substantial working capital.
b. Comfortable current ratio of assets to liabilities.
c. Proper bank relations.
d. Favorable record of earings, net worth and working capital.
e. Proven ability and character of management. The dealer, of course, acquaints the potential buyer of commercial paper with character of management; organization of company; present policies; history; current outlook; and its latest statement and financial standing.

Commercial paper is an excellent secondary reserve, provided that the investing bank can pinpoint its maturities. Unlike Treasury Bills, commercial paper is hard to sell prior to maturity; as there is no formal secondary market for commercial paper. In the event that the bank is in a liquidity squeeze, it has two alternatives, either to sell the commercial paper to a correspondent bank, or providing it is eligible, to pledge it to a borrowing from the Federal Reserve Bank.

The rapid growth of this market has had a sharp impact on the commercial banks. Developments in dealer paper suggest a strong movement away from commercial bank financing. Several new borrowers (such as public utilities) have entered the market; and up until recently, these firms did not issue commercial paper but relied principally on commercial banks for their financing.

Bankers' Acceptances

A banker's acceptance is a time draft or bill of exchange which has been drawn on and accepted by a bank, trust company or other institution engaged primarily in the business of banking. When accepted, such a draft becomes an unqualified promise by the accepting bank to pay the draft at maturity.

Member banks of the Federal Reserve System are authorized by the Federal Reserve Board (Regulation C) to accept commercial drafts and bills up to 50 percent of their paid up and unimpaired capital stock and surplus; except that with permission of the Board of Governors any such member bank (approximately 68 banks) may accept such drafts or bills up to 100 percent of such capital and surplus, but the aggregate of such acceptances growing out of domestic transactions shall in no event exceed 50 percent of such capital and surplus. In addition, some member banks (approximately 48) are permitted by the Federal Reserve Board to accept bills to create dollar exchange up to 50 percent of capital and surplus. Therefore, the acceptance power of a member bank for all types of acceptances is 150 percent of capital and surplus. There is a further limitation that acceptances, to create dollar exchange, must have a maturity of not more than three months. All other types may have a maturity of not more than 6 months.

The Federal Reserve Act authorized member banks to accept drafts or bills of exchange drawn upon them to finance four broad categories of transactions.

a. The import and export of goods.
b. The shipment of commodities within the United States.
c. The storage of readily marketable staple commodities, either in the United States or in foreign countries.
d. The furnishing of dollar exchange.

The mechanics of a banker's acceptance are as follows. Stevens & Co., a Boston wool importer, goes to his Boston bank for a letter of credit in favor of A.J. Ashton, an Australian exporter. The letter of credit states the details of the shipment and the credit terms and tells Ashton that he may draw drafts on the Boston bank for $50,000, the value of the wool shipment. Stevens & Co. agrees to put the Boston bank in funds to cover the accepted draft at maturity.

BANKERS' ACCEPTANCE — Illustration K

Boston, Mass., U.S.A., Date - August 1, 1965

Ninety days after sight

Pay to the order of The Fifth National Bank of Boston $ 50,000.00

FIFTY THOUSAND no/100 Dollars

Value received and charge the same to the account of:

Letter of Credit No.

To: The Fifth National Bank of Boston
Boston, Massachusetts 02106

The transaction which gives rise to the instrument is the import of: WOOL

from: ASTHINIA

to: UNITED STATES

ACCEPTED August 10, 1965

The Fifth National Bank of Boston, Massachusetts

Authorized Signature

A. J. Ashton

The Boston bank cables its correspondent in Australia to tell Ashton about the letter. Ashton then ships the wool. To make sure that the transaction is in order, he holds the bill of lading and other documents that will be needed in Boston to get the wool from the shipping company. He (A.J. Ashton) draws a draft on the Boston bank, say for 90 days after date, and presents it, together with the necessary documents, to the bank in Australia which pays him an amount less discount. Ashton is then pretty much out of the transaction. The Australian bank now owns the draft and sends it and all the accompanying papers to its Boston correspondent for presentation to the Boston bank. When the Australian bank presents the draft and documents, the Boston bank stamps "accepted" on the draft as long as everything is in order. Now the Australian bank has the Boston bank's commitment to pay the draft at maturity and can sell what is now a "Banker's acceptance" in the market at a discount to a dealer and have the proceeds credited to the Australian bank. The acceptance buyer has the Boston bank's obligation to pay $50,000 in 90 days from the date it has stamped on the bill. Now the Boston bank gives Stevens the shipping documents, in exchange for a trust receipt. He takes his wool, sells it, and uses the proceeds to pay the Boston bank before the maturity date of the banker's acceptance.

Quoted rates of discount by dealers, unless specifically designated otherwise, are for "prime" bills - those of the banks in the larger financial centers whose credit is well established and whose name is known both in the open market and at the Federal Reserve Bank. Off-prime bills are seldom traded in the open market. Occasionally, a large bank will discount a correspondent's bills at a rate determined by the discounting bank, usually within a range of 1/8 percent to 3/8 percent of the prime rate, and hold such bills in its portfolio until maturity.

As to safety and high credit of the acceptance itself, it might be sufficient to state that there never has been a loss to any investor, and this includes the period which witnessed the banking holiday of 1933.[1]

Neither commercial paper nor bankers' acceptances are used very frequently today to adjust reserve positions, but they do provide an excellent outlet for temporary funds.

[1] L. Meredith Maxson, First Boston Corporation.

Negotiable Certificates of Deposit

About nine years ago the large money market banks in New York City and other reserve city banks began issuing negotiable certificates of deposit in an effort to attract funds which institutional investors had been shifting to higher income money market instruments. The certificates are simply pieces of negotiable paper that tell large depositors that they have a certain amount of dollars at a particular bank on deposit. These certificates are generally issued in amounts of $100,000 or more, although they could range from $25,000 to $10 million, depending on the size of the issuing bank and the type of CD customer it is trying to attract. Such deposits may not be withdrawn prior to the stated maturity date, at which time the certificate matures and interest is paid at the rate originally agreed upon by the depositor and the bank. Time certificates (or CD's) did not originate in 1961, but prior to that time they represented primarily savings-type deposits and were generally not negotiable, and of course there was no secondary market for such paper. The offer of certificates also represented an attempt to increase the stability of deposits. The time deposits acquired are available to the issuing bank for loans and investments of longer maturities. Of course, no bank is assured that the maturing certificates will be rolled over into new certificates, therefore suggesting the possibility of a bind for funds at the maturity date. This was very evident during the latter part of 1969.

The most popular maturity had been in the one to three month area, but the recent raising (January 21, 1970) of the interest ceiling (Regulation Q of the Board of Governors of the Federal Reserve System) has attracted some new money at the 7 1/2 percent rate maturing in more than one year.

CD's may be in registered or bearer form, although the latter is more convenient for secondary market trading.

The Federal Reserve's Regulation Q, which sets the maximum rates payable on time and savings deposits, is a fundamental consideration in the market for CD's. When short-term open market rates rise above or even approach the prescribed ceiling, CD's cease to be competitive in the markets. Bankers have found it increasingly difficult to replace maturing certificates and are likely to experience large deposit losses (as was the case in the third quarter of 1969) as investors turn to higher yielding money market instruments.

CERTIFICATE OF DEPOSIT — Illustration L

CERTIFICATE OF DEPOSIT

5-45 Rev.

5-23
110

ROCKWELL NATIONAL BANK
100 ADAMS STREET
MILTON, MASSACHUSETTS

JANUARY 25, 1970 NO. 3135

THIS IS TO CERTIFY THAT THERE HAS BEEN DEPOSITED WITH THIS BANK

----------ONE MILLION ---------- DOLLARS $ 1,000,000.

PAYABLE TO ALPHA CEMENT COMPANY

on JANUARY 25 1971 with interest, to maturity only, at the rate

of 7 1/2 % per annum upon presentation and surrender of this certificate properly endorsed at the above office of this bank, neither the deposit evidenced hereby nor the interest thereon may be withdrawn before maturity. Payable at the Orange Trust Company, New York, New York, if desired.

Donald R. Smith
AUTHORIZED SIGNATURE

Howard T. Brown
AUTHORIZED SIGNATURE

Interest computed actual days on 360 day basis.

CERTIFICATE OF DEPOSIT

Prior to the introduction of the certificates of deposit, corporate funds on demand deposit with commercial banks drew no interest, and corporate treasurers were gradually withdrawing funds from banks and investing them in short-term investments such as U.S. Treasury Bills and commercial paper. The growth in the amount of negotiable time certificates was phenomenal. It has been estimated that outstanding CD's reached a peak of $24.5 billion in the fall of 1968 and at the present time amount to $11.7 billion.

Interest is paid on the par value of the certificate and is accrued on a 360-day basis. The rate to be paid is determined by money market conditions and is competitive with other money market instruments. The yield on a CD would probably have to be about 25 basis points above Treasury Bills to attract investors.

Most of the commercial banks in the country issue CD's, but it is estimated that the large money market banks in New York and Chicago have issued over 50 percent of the CD's outstanding.

The principal secondary market for certificates of deposit is centered around the trading operations of about ten U.S. Government securities dealers in New York. These ten dealers "make a market" and daily supply potential buyers with their daily bids and offerings. Certificates of deposit are classified as prime, lesser-prime, and non-prime. Certificates are designated prime simply because the bank is big and its name well-known. A list of "so-called" prime banks might include about 20 nationally known banks. About half of these banks are located in New York City, several in Chicago, and others in Boston, Philadelphia, Pittsburgh, and San Francisco.

While there may be little, if any, difference between prime and non-prime certificates as to quality, non-prime certificates are not as readily marketable. Prime name certificates of deposit usually trade at rates of 40 to 60 basis points higher than rates on comparable maturing U.S. Treasury Bills.

Some dealers prefer to trade only prime or lesser-prime certificates, inasmuch as their customers are only interested in such quality. Other dealers will trade certificates of some of the "so-called" non-prime certificates. These dealers proceed under the assumption that a buyer will probably not be found and they will be required to hold the certificates in their possession until maturity.

The bid rate to the seller of the non-prime certificates will be high enough to insure, insofar as possible, a profit on the certificate's interest accrued after deducting the interest cost of money borrowed to carry the certificate.

Dealers have encountered no special difficulties in borrowing to finance their holdings of certificates of deposit. New York "money market" banks will lend funds against certificates at the same rate they charge for call loans secured by U.S. Government securities.

The growth and development of the CD market has provided the money market banks with another means of reserve adjustment. In addition to borrowing from the Federal Reserves, buying Federal Funds, or liquidating short-term assets, a bank may now acquire additional funds by simply raising its rate payable on CD's, provided there is room under the ceiling set by Regulation Q. Of course CD's were not competitive with other short-term money market rates during 1969, but the revision of Regulation Q early in 1970 once again placed long CD's at 7 1/2 percent in a competitive position.

The Prime Rate

Banks have always had a preferential rate for their best customers. The prime rate concept apparently was not publicized on a national basis until 1933. The prime rate stood at 1 1/2 percent from 1933 until December 1947. Since 1947 we have had thirty-three changes and all such changes, with three exceptions, were initiated by large New York "money market" banks. The three exceptions were banks in Boston and Chicago. The current rate of 8 1/2 percent is the highest in the history of commercial banking in the United States. At the time of a change, a large bank officially posts such change, and in each case it has been followed in a matter of hours by increases or decreases by the other large banks throughout the country. Historically, the prime rate has been in the range of one to two percentage points above the Federal Reserve discount rate but is currently 2 1/2 percent above it. Changes in the prime rate are regarded by big business and the banking industry as one of the leading indicators of credit conditions.

Changes in the prime rate do not normally occur ahead of or even concurrently with shifts in the credit market. Rather, a change in the prime rate may be interpreted as confirming that a shift has already taken place and that no immediate reversal is anticipated.

HISTORY OF PRIME RATE – Illustration M

Banks have always had a preferential rate for their best customers. The prime rate concept apparently was not publicized on a national basis until 1933. It stood at 1½% until December 1947.

FEBRUARY 2, 1970

DATE	RATE	INITIATED BY
December 15, 1947	1¾%	Bankers Trust Company, N.Y.
August 10, 1948	2 %	Irving Trust Company, N.Y.
September 22, 1950	2¼%	First National City Bank, N.Y.
January 5, 1951	2½%	Bankers Trust Company, N.Y.
October 17, 1951	2¾%	First National City Bank, N.Y.
December 18, 1951	3 %	Chase Manhattan Bank, N.Y.
April 27, 1953	3¼%	Bankers Trust Company, N.Y.
March 17, 1954	3 %	Morgan Guaranty Trust Co., N.Y.
August 4, 1955	3¼%	Chase Manhattan Bank, N.Y.
October 14, 1955	3½%	First National City Bank, N.Y.
April 13, 1956	3¾%	Chase Manhattan Bank, N.Y.
August 20, 1956	4 %	First National Bank of Boston
August 7, 1957	4½%	Bankers Trust Company, N.Y.
January 21, 1958	4 %	Chase Manhattan Bank, N.Y.
April 21, 1958	3½%	Morgan Guaranty Trust Co., N.Y.
September 11, 1958	4 %	Chase Manhattan Bank, N.Y.
May 18, 1959	4½%	First National City Bank, N.Y.
September 1, 1959	5 %	First National City Bank, N.Y.
August 23, 1960	4½%	Manufacturers Hanover Tr. Co., N.Y.
December 6, 1965	5 %	First National Bank, Chicago
March 10, 1966	5½%	Morgan Guaranty Trust Co., N.Y.
June 30, 1966	5¾%	Chemical Bank N.Y. Tr. Co., N.Y.
August 17, 1966	6 %	First National City Bank, N.Y.
January 30, 1967	5¾%	First National City Bank, N.Y.
March 23, 1967	5½%	Morgan Guaranty Trust Co., N.Y.
November 21, 1967	6 %	Continental Illinois N/B, Chicago
April 19, 1968	6½%	Bankers Trust Company, N.Y.
September 25, 1968	6¼%	First National City Bank, N.Y.
December 2, 1968	6½%	Chase Manhattan Bank, N.Y.
December 18, 1968	6¾%	First National City Bank, N.Y.
January 7, 1969	7 %	First National City Bank, N.Y.
March 17, 1969	7½%	Morgan Guaranty Trust Co., N.Y.
June 9, 1969	8½%	Bankers Trust Company, N.Y.

CHAPTER VI

RELATIONS WITH CORRESPONDENT BANKS

Loan Participations

Loan participation and the purchase and sale of loans are an important part of correspondent bank relations. Many banks engage in such activity as another method of adjusting their reserve positions. For example, some of the large banks and particularly the "money market" banks sell participation in their brokers' loans to their out-of-town correspondents on a demand basis.

A common type of participation would originate with a country bank requesting a larger correspondent to participate in a loan which exceeds the legal limit of the bank making the request. Likewise, a city bank may go to a large money market bank with the same type of request.

Another method for a more permanent adjustment would be outright sales from the portfolio of one bank to another. Banks with a low loan demand may buy commercial loans from a loaned-up bank in another area. Likewise, banks that are over-loaned may sell or participate a portion of their loans to another bank that is anxious to employ excess funds.

Most of the smaller banks are, at times, required to obtain assistance from their city correspondents, but many of them are reluctant to do so. One of the reasons is that they are afraid the city bank will cultivate the friendship of their customer and probably take over the account. However, in recent years the city banks have become more aware of this situation and are pursuing a more conservative approach and want to retain the goodwill of their country correspondents.

Direct Borrowing

Country banks in need of temporary funds may go to their city correspondent for such accommodation. Such requests may be made by telephone by officials authorized to borrow in accordance with a borrowing resolution which is kept on file at the city banks. Such requests must be confirmed in writing and mailed the same day. Such

LOAN PARTICIPATION – Illustration N

No. 11599 $ 100,000.00

THE NEW BOSTON NATIONAL BANK
BOSTON, MASSACHUSETTS

NON-NEGOTIABLE LOAN PARTICIPATION CERTIFICATE

The New Boston National Bank of Boston hereby certifies that

The State Bank and Trust Company, Portland, Maine

is entitled to a participation of one hundred thousand ----------00/100 Dollars

Par value in loan of five hundred thousand ----------00/100 Dollars ($500,000.00)

to Clayton Clark and Spear Corporation, Chicago, Illinois

dated August 1, 1965 and payable on December 1, 1965

held by the New Boston National Bank of Boston as agent for the collection of principal and interest thereof for the benefit ratably of the participants. The New Boston National Bank of Boston may hold an interest in said loan on its own account.

In consideration of the issue hereof and by the acceptance of this participation certificate, the owner hereof expressly agrees that said New Boston National Bank of Boston shall be free from liability of any kind on account of this participation, except for the proportionate distribution of any amounts received by it for such distribution.

Boston, Mass., August 27 1965

J. Robert Anderson
Authorized Official
V. P.

ILLUSTRATION N

loans are generally credited to the borrower's deposit account, unless the borrower requests otherwise. In many instances the borrower has the funds transferred to its account at the Federal Reserve Bank. Most loans are made on a term basis, and if such loans are secured by U.S. Government bonds, the interest charged is the same as the current prime rate; if other types of collateral are pledged, the rate would vary depending upon the going rates in the market and the quality and the marketability of the collateral pledged.

This is a fast and convenient way to borrow, as the banks hold a part of their investment portfolio with their correspondents, and it is a simple matter to release them from safekeeping to be pledged to a loan. There are some banks that prefer borrowing from their correspondent on a secured basis rather than buying Federal Reserve Funds or seeking such accommodation from the Federal Reserve Bank.

CHAPTER VII

THE DISCOUNT WINDOW

Member banks may replenish their reserves in the Federal Reserve Bank by discounting their own notes secured by U.S. Government securities or other satisfactory collateral, or by discounting eligible customer notes. In either case the proceeds are credited to the member bank, thereby increasing their reserves. The rate of interest charged for these loans by the Federal Reserve Bank is called the discount rate. By raising or lowering the discount rate, the Reserve Banks can make it more or less expensive for member banks to get additional reserves. Access to the discount window provides assurance that in time of real need, individual banks may be able to maintain their liquidity. Ordinarily, a need for reserve funds would be met first by liquidation of secondary reserves as described in the preceding chapters. The tradition against being continually in debt to any source has tended to limit member bank borrowing. Federal Reserve discount policy is administered by the individual Federal Reserve Bank under the provisions outlined in the Board's Regulation A.

Foreword to Regulation A

> "Access to the Federal Reserve discount facilities is granted as a privilege of membership in the Federal Reserve System in the light of the following general guiding principles.
>
> "Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. Under ordinary conditions, the continuous use of Federal Reserve credit by a member bank over a considerable period of time is not regarded as appropriate.

NUMBER AND AMOUNT OF NOTES HANDLED FOR MEMBER BANKS BY CLASS OF BORROWING

Illustration O

(1959 -1969) Federal Reserve Bank of Boston

Amount in thousands

Year	No. of Banks Accommodated	Advances on U. S. No. of Notes	Advances on U. S. Dollar Amount	Advances On Eligible Paper No. of Notes	Advances On Eligible Paper Dollar Amount	Advances-Provisions Section 10(b) No. of Notes	Advances-Provisions Section 10(b) Dollar Amount	Rediscounts Of Eligible Paper No. of Notes	Rediscounts Of Eligible Paper Dollar Amount
1959	171	1,828	$2,878,887	1	$ 60	1	$ 1,500	60	$380
1960	178	1,572	1,444,122	1	5,000	1	50	14	115
1961	146	745	474,876	0	0	1	206	0	0
1962	132	710	687,873	8	13,000	2	1,300	0	0
1963	127	748	1,206,233	0	0	0	0	0	0
1964	130	921	1,406,315	3	310	0	0	0	0
1965	106	801	2,699,764	0	0	0	0	0	0
1966	140	1,409	3,958,216	12	145,995	1	150	0	0
1967	96	509	1,260,574	0	0	0	0	0	0
1968	119	1,235	6,146,321	4	72,175	1	20,000	0	0
1969	150	2,646	9,499,311	83	3,287,166	26	88,375	0	0

"In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. It keeps informed of and takes into account the general character and amount of the loans and investments of the member bank. It considers whether the bank is borrowing principally for the purpose of obtaining a tax advantage or profiting from rate differentials and whether the bank is extending an undue amount of credit for the speculative carrying of, or trading in securities, real estate, or commodities, or otherwise.

"Applications for Federal Reserve credit accommodation are considered by a Federal Reserve Bank in the light of its best judgement in conformity with the foregoing principles and with the provisions of the Federal Reserve Act."

Borrowings Secured by Direct Obligations of, and Obligations Fully Guaranteed as to Principal and Interest by the United States

The Federal Reserve Banks opened in the fall of 1914, and up until September of 1916 member banks could borrow from their regional bank only by rediscounting eligible paper. At that time the Federal Reserve Act was amended to permit advances secured by either eligible paper or U.S. Government securities. This action was related to the problems of financing World War I.

During the period from 1914 to 1934 most member banks were familiar with the concept of eligibility. Many banks maintained records so that they could readily determine the amount of eligible paper in their portfolio, and the loan policy was aimed at holding a certain percent of its loans as eligible paper that could readily be discounted at the Federal Reserve Bank. Despite a low discount rate, banks used the discount window sparingly between 1933 and 1951. From 1935 to 1940 daily borrowing generally averaged below $10 million; average daily borrowings during the year 1969 averaged $1.105 billion. For the most part, banks held large excess reserves and were under little pressure to borrow. Even after the business recovery of the early 40's, borrowings remained at low levels. By that

BORROWING RESOLUTION – Illustration P

"WHEREAS, it is desirable that the officers of this Bank should, from time to time, be able to rediscount its bills receivable, and to secure advances from the Federal Reserve Bank of Boston on promissory notes of this Bank secured by collateral, as provided by the Federal Reserve Act or any other Statute of the United States and any amendments thereto now in force or which may hereafter be made:-

"NOW, THEREFORE, RESOLVED, that the President, any Vice-President, and Chairman of the Board, Cashier, and Assistant Cashier, of this institution, and their
(indicate by title any other authorized officers)
successors in office, be, and any One (indicate whether one, or two, etc.) of them hereby is/are authorized and empowered, in the name and on behalf of this institution, from time to time:

"I. To rediscount, with the Federal Reserve Bank of Boston, notes, drafts, acceptances, bills of exchange, and other bills receivable, of the kinds and maturities made eligible for rediscount under the Federal Reserve Act or any other Statute of the United States and any amendments thereto now in force or which may hereafter be made, in such sums and upon such terms as may to them or either of them seem advisable;

"II. To execute and deliver, to the Federal Reserve Bank of Boston, the promissory note or notes of this Bank, secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal Reserve Banks under the provisions of the Federal Reserve Act or any other Statute of the United States and any amendments thereto now in force or which may hereafter be made, or by the deposit or pledge of bonds or notes or Treasury bills or certificates of indebtedness of the United States, or secured as otherwise permitted under the provisions of the Federal Reserve Act or any other Statute of the United States and any amendment thereto now in force or which may hereafter be made;

"III. In order to carry out the purposes of the foregoing votes, to endorse on behalf of this Bank, either with or without written waiver of demand, notice and protest, any notes, drafts, bills of exchange, bills receivable, or bankers' acceptances, whether rediscounted or deposited as security; to deposit, as security or pledge for such note or notes of this Bank, bonds or notes or Treasury bills or certificates of indebtedness of the United States; and to deposit, endorse, assign and/or transfer any other assets of this Bank as security or pledge for such note or notes of this Bank; and to do any and all other acts and sign any and all other instruments or papers necessary or advisable in the premises, including, without limiting the generality of the foregoing, certification as to eligibility of paper or other assets rediscounted or deposited as collateral; and

that the foregoing powers shall continue until express notice of their revocation has been duly given in writing to the said Federal Reserve Bank of Boston."

I, the undersigned, do hereby certify that the foregoing is a true and correct copy of a Resolution of the Board of Directors of the Southern National Bank of Boston,
(Name of Bank)
Boston, Massachusetts, duly adopted at a regular meeting of the said Board,
(Location)
held on June 2, 1968 a quorum being present, and of the whole of the said Resolution, as set forth in the minutes of the said meeting, and that the said Resolution has not been rescinded or modified.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the corporate seal of the said Bank this 24 day of May 19 68.

(Seal)

Roger Johnson
Cashier or Secretary of the
Board of Directors

B.D. 16
(6-64 100)

time, banks held large quantities of Government securities and the Federal Reserve's practice of pegging the market for these securities, instituted in 1942, eliminated the market risk of adjusting reserve positions through sales of Governments. The Treasury-Federal Reserve Accord in the spring of 1951, however, ended the pegged market for Government securities and began a new chapter in the history of the discount window. As indicated by the illustration, in the First Federal Reserve District discounting increased sharply during the year of 1965. Inasmuch as our banks had heavy portfolios of U.S. Governments, there was little need to be concerned with eligible paper.

As indicated in the illustration, the borrowing from the Federal Reserve Bank during the past ten years has been principally by advances on promissory notes secured by direct obligations of the United States and its agencies. Advances secured by Governments as collateral are the most convenient way to borrow. The collateral is in large denominations and is readily available. Most of the member banks have U.S. Government securities in safekeeping at the Federal Reserve Bank so they may be immediately pledged as collateral to an advance. It is also possible for a member bank that holds its collateral at a New York correspondent bank to make arrangements for delivery of a trust receipt to the Boston Federal Reserve Bank. On the day of the advance the borrowing bank would indicate to its New York correspondent by telephone a complete description of the securities to be pledged, and the New York correspondent would telephone the Discount Department at the Federal Reserve Bank of Boston to be followed by a confirming wire.

The mechanics of borrowing on U.S. Government securities are quite simple. The member bank merely sends in its promissory note signed by a duly authorized official, indicating the securities to be pledged which may be held in book entry; or if definitive securities are to be pledged, we would be advised of the number on the safekeeping receipt. Generally, the date of the note is the date on which it is received by the Federal Reserve Bank, and the credit is passed on the same day. The note is automatically charged to the bank's reserve account on the maturity date. If the bank wishes to rebate the note, in whole or in part, a letter or telephone call, subject to written confirmation, is all that is necessary.

#162

PROMISSORY NOTE-UNITED STATES AND AGENCY BONDS

Illustration Q

Boston, Massachusetts
Location of Bank

$ 2,000,000.00

February 2, 1970
Date

Seven (7) days after date, for value received, the undersigned bank promises to pay to the **Federal Reserve Bank of Boston**, or order, at the office of said Federal Reserve Bank in the City of Boston, Massachusetts,

Two Million and ----------no/100

Dollars, having deposited with and pledged to said Federal Reserve Bank, as collateral security for the payment of this note and any other liability or liabilities, whether direct or contingent, of the undersigned bank to the said Federal Reserve Bank, due or to become due or that may be hereafter contracted, the following obligations:

$ 100,000	U. S. Treasury Bills due April 22, 1970	BE 3125
100,000	U. S. Treasury Notes 8% due May 15, 1971	BE 3091
500,000	U. S. Treasury Bonds 4 1/2% due May 15, 1974	BE 3011
100,000	Federal Intermediate Credit Bank Debentures	SK 349125
200,000	Federal Home Loan Bank Bonds	SK 349872
100,000	Federal Land Bank Bonds	SK 349727
200,000	Federal National Mortgage Association Debentures	SK 341746
100,000	Export-Import Bank Notes 6 5/8% due September 19, 1971	SK 349137
200,000	Farmers Home Administration Notes 8 7/8% due January 31, 1975	SK 309127
100,000	Farmers Home Administration Notes 8.90% due January 31, 1980	SK 301171
100,000	Banks for Cooperatives 8.65% due August 3, 1970	SK 301875
200,000	Worcester Housing Authority Bond 5.25% due August 1, 1999	SK 312485

FROM: Edward R. Rogers To: E. J. McCarthy

The said Federal Reserve Bank is also given a lien for the payment of this note and any of the said other liabilities upon all the property or securities now or hereafter in the possession of said Federal Reserve Bank, which have been or may be received from or for the account of the undersigned bank, including items in process of collection and the proceeds thereof, and also upon any balance to the credit of the undersigned bank in its deposit account with the said Federal Reserve Bank, and it is hereby agreed by the undersigned bank that the said Federal Reserve Bank has the right to require such additional security as it may deem proper, and, on failure to respond forthwith to such requirement or on the nonpayment of this note, when due, or on the nonpayment of any other liability or liabilities, when due, of the undersigned bank, the said Federal Reserve Bank, or any holder hereof, is hereby given full authority to sell, assign and deliver, or collect the whole or any part of the above named collaterals, or any substitute therefor, or any addition thereto at any public or private sale or any brokers' board or stock exchange, at any time or times hereafter, without demand, advertisement or notice; and, upon such sale, the said Federal Reserve Bank or the holder hereof may become the purchaser of the whole or any part of such collaterals, free from any right of redemption, and, after deducting all legal or other costs and expenses for collection, sale and delivery, may apply the residue of the proceeds of such collections, sale or sales to the payment of this note and of any, either or all of said other liabilities, as the said Federal Reserve Bank, or its assigns, shall deem proper, returning the over-plus to the undersigned bank. The undersigned bank hereby authorizes and empowers said Federal Reserve Bank, at its option, at any time, to appropriate and apply to the payment of any or all of the liabilities of the undersigned bank to the Federal Reserve Bank, whether direct or contingent, or whether then due or to become due, or whether now existing or hereafter contracted, any money or balance now or hereafter in the hands of said Federal Reserve Bank, on deposit or otherwise, to the credit of or belonging to the undersigned bank. It is agreed that in the event of the insolvency or bankruptcy of, or the appointment of a receiver for, the undersigned bank, or in the event of its property and business being taken possession of, or its business being suspended by, or it being closed by, the lawfully authorized governmental agency or authority, this note and all the said other liabilities and each of them shall immediately become due and payable, without demand or notice.

(Name of bank) Dollar National Bank

By Edward R. Rogers

(Title of officer) Executive Vice President

BD 15
Rev. (5-69 2M)

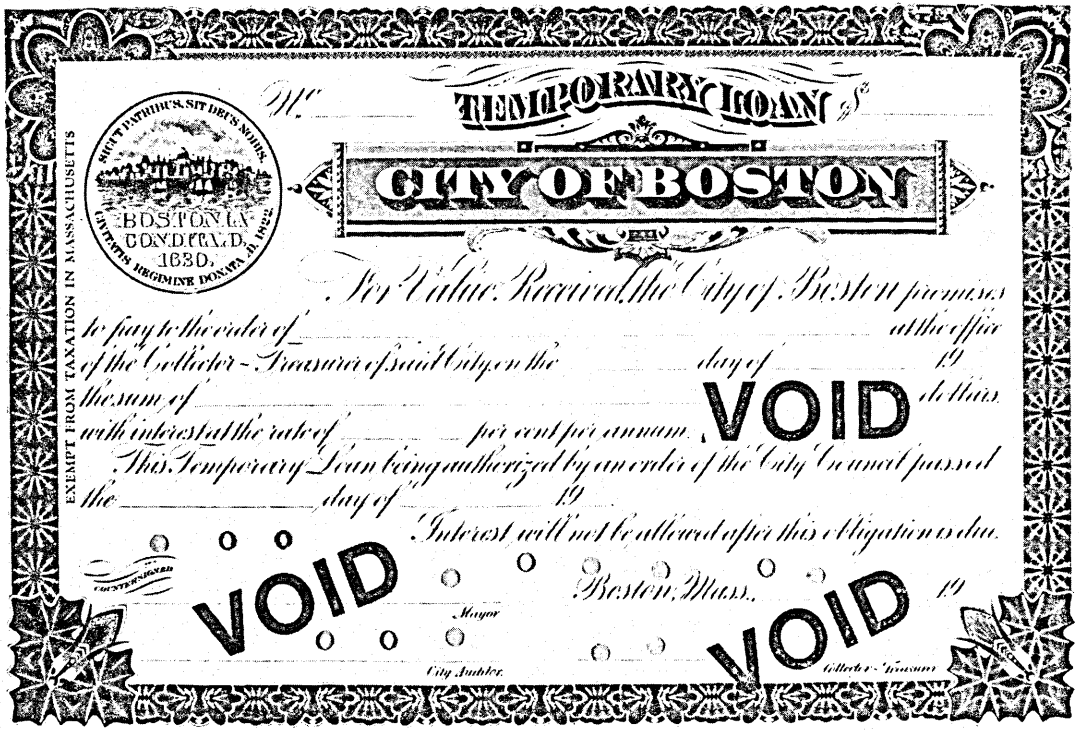
Frequently member banks borrow by telephone. In the case of a so-called "dummy note" the bank calls and specifies amount, collateral and number of days. The officer telephoning must be one who is authorized to borrow money in accordance with the borrowing resolution on file at the Federal Reserve Bank. The bank immediately puts its note in the mail as confirmation of the telephone request. The Federal Reserve Bank then credits the borrowing bank's account on the day the telephone call is received by putting through the "dummy note."

In addition to U.S. Treasury Bills, certificates of indebtedness, Treasury Notes, and Treasury Bonds, the following agency obligations are now eligible as collateral for an advance at the *discount rate.*

a. Federal Intermediate Credit Bank debentures.
b. Federal Home Loan Bank notes and bonds.
c. Federal Land Bank bonds.
d. Bank for Cooperative debentures.
e. Federal National Mortgage Association notes, debentures and guaranteed certificates of participation.
f. Obligations of or fully guaranteed by the Government National Mortgage Association.
g. Merchant Marine bonds.
h. Export-Import Bank notes and guaranteed participation certificates.
i. Farmers Home Administration insured notes.
j. Notes fully guaranteed as to principal and interest by the Small Business Administration.
k. Federal Housing Administration debentures.
l. District of Columbia Armory Board bonds.
m. Tennessee Valley Authority bonds and notes.
n. Bonds and notes of local urban renewal or public housing agencies fully supported as to principal and interest by the full faith and credit of the United States pursuant to Section 302 of the Housing Act of 1961 (42 U.S.C. 1421a(c), 1452(c)).

In addition to the above types of securities, a Federal Reserve Bank may accept tax anticipation notes with a maturity not in excess of six months from the date of the pledge. The Reserve Bank must satisfy itself that sufficient tax or other assured revenues earmarked

TAX ANTICIPATION NOTE — Illustration R



INTEREST ON THIS NOTE TO MATURITY

for payment of such obligations will be available for that purpose at maturity or within six months from the date of advance if no maturity is stated.

Borrowings Secured by Eligible Paper

Eligible paper in general consists of notes, drafts, or bills of exchange which have been issued or drawn for a commercial or agricultural purpose and the proceeds of which have been used, or are to be used

a. in producing, purchasing, carrying or marketing goods or agricultural products in one or more of the steps of the process of production, manufacture or distribution; or

b. in meeting current operating expenses of a commercial, agricultural or industrial business; or

c. for the purpose of carrying or trading in direct obligations of the United States.

To be eligible for rediscount or acceptable as collateral on advances, notes of industrial and commercial borrowers must have a maturity of not more than 90 days from the date of pledge or discount, exclusive of days of grace. The Federal Reserve Board has concluded that, since *demand paper* is due and payable on the date of its issue, it satisfies the maturity requirements of the statute. Therefore, demand paper which otherwise meets the eligibility requirements of the Federal Reserve Act and Regulation A is eligible for discount and as security for advances by Reserve Banks. Agricultural paper must have a maturity of not more than nine months from date of pledge or discount, exclusive of days of grace.

Paper is not eligible for discount if the proceeds have been used or are to be used for permanent or fixed investments or for any fixed capital purpose, or for financing transactions of a purely speculative character or for carrying or trading in stocks, bonds, or other investment securities except direct obligations of the United States. Except with the permission of the Board of Governors, no Federal Reserve Bank may discount for a member bank any paper acquired from, or bearing the signature or endorsement of a nonmember bank. However, the Federal Reserve Bank may discount such paper otherwise

ELIGIBLE PAPER NOTE — Illustration S

B.D. 3 8-59

Rockwell, Connecticut
Location of Bank

$ 100,000.00

February 2, 1970
Date

Seven (7) days after date, for value received, the undersigned bank promises to pay to the Federal Reserve Bank of Boston, or order, at the office of said Federal Reserve Bank in the City of Boston, Massachusetts,

One Hundred Thousand and----------no/100 Dollars,

having deposited with and pledged to said Federal Reserve Bank, as collateral security for the payment of this note and any other liability or liabilities, whether direct or contingent, of the undersigned bank to the said Federal Reserve Bank, due or to become due or that may be hereafter contracted, notes, drafts, bills of exchange, bankers' acceptances, and/or other security, as described in the schedule included in the application for advance, dated February 2, 1970 accompanying and made a part hereof. The said Federal Reserve Bank is also given a lien for the payment of this note and any of the said other liabilities upon all the property or securities now or hereafter in the possession of said Federal Reserve Bank, including items in process of collection and the proceeds thereof, and also upon any balance to the credit of the undersigned bank in its deposit account with the said Federal Reserve Bank, and it is hereby agreed by the undersigned bank that the said Federal Reserve Bank has the right to require such additional security as it may deem proper, and, on failure to respond forthwith to such requirement or on the non-payment of this note or on the nonpayment of any other liability or liabilities of the undersigned bank, the said Federal Reserve Bank, or any holder hereof, is hereby given full authority to sell, assign and deliver, or collect the whole or any part of the above named collaterals, or any substitute therefor, or any addition thereto at any public or private sale or on any brokers' board or stock exchange, at any time or times hereafter, wtihout demand, advertisement or notice; and, upon such sale, the said Federal Reserve Bank or the holder hereof may become the purchaser of the whole or any part of such collaterals, free from any right of redemption, and, after deducting all legal or other costs and expenses for collection, sale and delivery, may apply the residue of the proceeds of such collections, sale or sales for the payment of this note and of any, either or all of said other liabilities, as the said Federal Reserve Bank, or its assigns, shall deem proper, returning the over-plus to the undersigned bank. The undersigned bank hereby authorizes and empowers said Federal Reserve Bank, at its option, at any time, to appropriate and apply to the payment of any or all of the liabilities of the undersigned bank to the Federal Reserve Bank, whether direct or contingent, or whether then due or to become due, or whether now existing or hereafter contracted, any money or balance now or hereafter in the hands of said Federal Reserve Bank, on deposit or otherwise, to the credit of or belonging to the undersigned bank. It is agreed that in the event of the insolvency or bankruptcy of, or the appointment of a receiver for, the undersigned bank, or in the event of its property and business being taken possession of, or its business being suspended by, or it being closed by, the lawfully authorized government agency or authority, this note and all the said other liabilities and each of them shall immediately become due and payable, without demand or notice.

Rate of Interest or Discount

9

9 1/2

9

9

9

9

8 1/2

8 1/2

(Name of bank) City Trust Company

By Milton Smith

(Title of officer) Executive Vice President

ELIGIBLE PAPER APPLICATION — Illustration T

B. D. 3 A

To Be Made In Duplicate

No. 37

APPLICATION FOR ADVANCE

To the Federal Reserve Bank of Boston,
Boston, Massachusetts.

Date February 2 1970

We, the City Trust Co. ~~Bank of~~ Rockwell, Connecticut hereby make application for an advance of $ 100,000 upon our promissory note for Seven (7) days secured by notes, drafts, bills of exchange or acceptances aggregating $ 101,500.00 which are listed in detail in the following schedule.

You are hereby authorized to charge to our account at maturity this advance or to charge to our account at any time hereafter any of the paper listed below which you may deem ineligible or undesirable.

We hereby certify that, to the best of our knowledge and belief, the paper which is listed below is eligible as security for the promissory note of this bank under Section 13 of the Federal Reserve Act and the Regulations of the Federal Reserve Board, that none of the paper was acquired from non-member banks; and (if the applicant is a State bank or trust company) that none of the borrowers liable on such paper is liable for borrowed money to the applying bank in an amount greater than that which could be borrowed lawfully from the applying bank if it were a national bank.

On this date the total amount of money borrowed by this bank on bills payable, rediscounts or otherwise, **not including the advance covered by this application,** is as follows:—

Federal Reserve Bank of Boston $ 400,000 ; Elsewhere $ -0- ; Total $ 400,000

City Trust Company ~~National Bank~~
Executive Vice Pres. ~~Treasurer~~ ~~Cashier~~
Milton Smith

Rate of Interest or Discount Received	MAKER / INDORSERS	POST-OFFICE ADDRESS or Place of Business	BUSINESS List business of party receiving proceeds	AMOUNT DUE AT MATURITY (Principal plus Interest if any)	MATURITY	Date of Last Statement on File
9	City Shoe Corporation None	10 McGreggor St. Rockwell, Connecticut	Leather Fabric Sportswear	20,000.00	3/12/70	12/31/69
9 1/2	Steel Company, Inc. Robert Brown	5 Main Street Rockwell Connecticut	Steel	25,000.00	Demand	9/30/69
9	Torrington Sand & Gravel Co. None	2 Atlantic St. Rockwell Connecticut	Mfg. & Dist.	20,000.00	3/26/70	12/31/69
9	Independent Pipe & Supply Corp. None	10 South Street Rockwell Connecticut	Wholesale Pipe Supplies	5,000.00	4/1/70	10/31/69
9	Brown Card Co., Inc. None	8 Congress St. Rockwell Connecticut	Greeting Cards	12,000.00	Demand	6/30/69
8 1/2	National Felt Company, Inc. None	5 Broadway Rockwell Connecticut	Wholesale Felt	10,000.00	4/10/70	6/30/69
8 1/2	Smith Leather Corporation Robert Smith	2 Quincy St. Rockwell Connecticut	Mfg. Cut Soles	9,500.00	4/22/70	9/30/69
				101,500.00		

eligible for discount if the paper was bought on the open market or otherwise acquired in good faith and not for the purpose of obtaining credit for a nonmember bank.

The procedure used in handling advances secured by eligible paper is very similar to that of borrowing on government securities, other than the processing of the collateral (eligible paper), which is much more complicated.

Such borrowing is very time-consuming, both on the part of the member bank and on the part of the Federal Reserve Bank. Both the borrower and the Federal Reserve Bank must determine if the collateral meets the eligibility test as set forth by the Federal Reserve Act and Regulation A of the Board of Governors of the Federal Reserve System.

The Federal Reserve Bank of Boston requires the borrower to file an application in duplicate, setting forth the maker of the note, the endorser, place of business, type of business, amount due at maturity, and maturity date on each piece of paper offered as collateral. Each note must be endorsed by the member bank (an allonge is acceptable) and physically shipped to the Federal Reserve Bank, together with a copy of a recent balance sheet and operating statements on all notes of $5,000 or more.

The member bank must then substitute in its file a record in lieu of the actual notes. It has been reported that some banks make a photostatic copy of each note that is forwarded to the Federal Reserve Bank. An additional reason for not borrowing on eligible paper is that it has become apparent to the customer that his bank has borrowed on his note. Banks don't like to have their customers know that they occasionally have to borrow. Federal Reserve Banks stand ready to make an advance on eligible paper when such an advance appears necessary. This type of accommodation has increased markedly since 1963.

Rediscounts of Eligible Paper

The procedure in rediscounting eligible paper is similar to that in borrowing on advances secured by eligible paper. Both the Reserve Banks and the member banks find that rediscounting is less convenient than borrowing on their own note secured by eligible paper. The important difference is that an advance may be made in the exact amount and maturity needed, and the Reserve Bank generally extends short-term credit not in excess of seven days. It is difficult for a bank to select eligible paper of precisely the right amounts and maturities to offer as rediscounts.

It is much simpler for the Federal Reserve Bank to handle an advance for seven days secured by eligible paper than to rediscount many notes, for the obvious reason that fewer calculations are required. There is less bookkeeping and filing in handling one note than in dealing with several records for each individual note. It has become our policy in recent years to request our member banks to borrow on their own seven-day note and secure it with eligible paper rather than rediscounting their customers notes. As indicated in the illustration, we have not rediscounted any eligible paper since March 1960.

Borrowings Under Section 10 (b)

Another method of borrowing that is not familar to many of the banks is under the authority of Section 10(b) of the Federal Reserve Act. Advances under this section may be granted on any satisfactory collateral. Such advances are required by law to carry a rate of 1/2 of 1 percent in excess of borrowings secured by eligible paper or U.S. Government securities. The procedure for borrowing under these provisions is very similar to advances on eligible paper or government securities. The borrower must forward his note, together with an application listing the collateral to be pledged.

The borrowings at the Federal Reserve Bank of Boston made under this provision have been secured by municipal bonds. In each instance to date, the collateral to be pledged was held in safekeeping and merely required the endorsement of the borrower with instructions to collateralize the loan. It is also possible for a member bank which holds its collateral at a correspondent bank to make arrangements to deliver a trust receipt to the Federal Reserve Bank of

SECTION 10(b) — Illustration U

NOTE

Milton, Maine
Location of Bank

$ 1,000,000.00

February 2, 1970
Date

Seven (7) days after date, for value received, the undersigned bank promises to pay to the Federal Reserve Bank of Boston, or order, at the office of said Federal Reserve Bank in the City of Boston, Massachusetts,

One Million and ----------no/100 Dollars,

having deposited with and pledged to said Federal Reserve Bank, as collateral security for the payment of this note and any other liability or liabilities, whether direct or contingent, of the undersigned bank to the said Federal Reserve Bank, due or to become due or that may be hereafter contracted, notes, drafts, bills of exchange, bankers' acceptances, or other security, as described in the schedule included in the application for advance, dated February 2, 1970 accompanying and made a part hereof. The said Federal Reserve Bank is also hereby given a lien for the payment of this note and any of the said other liabilities upon all the property or securities now or hereafter in the possession of said Federal Reserve Bank, including items in process of collection and the proceeds thereof, and also upon any balance to the credit of the undersigned bank in its deposit account with the said Federal Reserve Bank, and it is hereby agreed by the undersigned bank that the said Federal Reserve Bank has the right to require such additional security as it may deem proper, and, on failure to respond forthwith to such requirement or on the nonpayment when due of this note or on the nonpayment when due of any other liability or liabilities of the undersigned bank, the said Federal Reserve Bank, or any holder hereof, is hereby given full authority to sell, assign and deliver, or collect the whole or any part of the above named collaterals, or any substitute therefor, or any addition thereto at any public or private sale or on any brokers' board or stock exchange, at any time or times hereafter, without demand, advertisement or notice; and, upon such sale, the said Federal Reserve Bank or the holder hereof may become the purchaser of the whole or any part of such collaterals, free from any right of redemption, and, after deducting all legal or other costs and expenses for collection, sale and delivery, may apply the residue of the proceeds of such collections, sale or sales to the payment of this note and of any, either or all of said other liabilities, as the said Federal Reserve Bank, or its assigns, shall deem proper, returning the over-plus to the undersigned bank. The undersigned bank hereby authorizes and empowers said Federal Reserve Bank, at its option, at any time, to appropriate and apply to the payment of any or all of the liabilities of the undersigned bank to the Federal Reserve Bank, whether direct or contingent, or whether then due or to become due, or whether now existing or hereafter contracted, any money or balance now or hereafter in the hands of said Federal Reserve Bank, on deposit or otherwise, to the credit of or belonging to the undersigned bank. It is agreed that in the event of the insolvency or bankruptcy or failure of, or the appointment of a conservator or liquidating agent or receiver for, the undersigned bank, or in the event of the undersigned being closed or suspended by its board of directors or, its property and business being taken possession of, or its business being suspended by, or it being closed by, the lawfully authorized governmental agency or authority, this note and all the said other liabilities and each of them shall immediately become due and payable, without demand or notice.

(Name of bank) Lake National Bank

By Richard McKenzie

(Title of officer) Executive Vice President

B.D. 97(A)

APPLICATION SECTION 10(b) — Illustration V

B.D. 97 (11-62 500)

(To be made in duplicate)

No. 37

APPLICATION FOR ADVANCE
UNDER SECTION 10 (b) OF THE FEDERAL RESERVE ACT AS AMENDED

Date February 2 1970

To the Federal Reserve Bank of Boston,
Boston, Massachusetts.

The undersigned bank, Lake National Bank, hereby makes application for an advance of $ 1,000,000. upon its promissory note on form B.D. 97(A) maturing Seven (7) days from the date of such advance secured by the bonds, notes, drafts, bills of exchange, acceptances or other security, aggregating $ 1,200,000. in face amount, which are hereinafter listed in detail in Schedule A below.

The undersigned bank hereby certifies that the security offered to this advance has not been acquired from a non-member bank otherwise than in accordance with Section 5 of Regulation A; and that except as otherwise noted in Schedule A the undersigned has on file a statement which adequately reflects the financial worth of a party primarily liable on the paper offered as security for this advance.

You are hereby authorized to charge this advance to the account of the undersigned at any time hereafter if a demand note, or at maturity if a time note, or to charge to the account of the undersigned the loan value as determined by you of any of the collateral now or hereafter securing this advance which you may deem unsatisfactory or undesirable.

On this date, the total amount of money borrowed by this bank on bills payable, rediscounts or otherwise, not including the advance covered by this application, is as follows:

Federal Reserve Bank of Boston—$ 2,000,000. Elsewhere—$ 500,000. Total—$ 2,500,000.

(Name of bank) Lake National Bank

By Richard McKenzie

(Title of officer) Executive Vice President

(Must be signed by an officer authorized by resolution filed with the Federal Reserve Bank)

Schedule A

Description	Face Amount	This Space for F. R. Bank only — APPRAISAL				
		Price	Market Value	%	Loan Value	Rating
Mass. Turnpike Authority (Sumner Tunnel) 4 3/4% due April 1, 1999	300,000.	73	219,000.			BAA
Maine Turnpike Authority (Revenue) 4% due January 1, 1989	300,000.	76	228,000.			A
Conn. (Expressway G. O.) 3 1/4% due January 1, 1976	200,000.	75	150,000.			AAA
Rhode Island Turnpike & Bridge Authority 4.90% due December 1, 2016	400,000.	67	268,000.			A
	1,200,000.		865,000.			

ILLUSTRATION V

Boston. On the day of the advance, the borrowing bank would indicate to its correspondent by telephone a complete description of the securities to be pledged. The correspondent would then advise the Federal Reserve Bank of Boston by telephone, subject to a confirming telegram.

Presumably, a member bank would prefer not to borrow on this type of loan if it owned government securities which were available as collateral. But if a member bank had exhausted its government securities, it probably would be willing to pay the penalty rate to avoid the detail of rediscounting or pledging eligible paper. It is assumed that the Federal Reserve Bank of Boston would not deny the member bank this privilege.

As indicated above, each application must be accompanied by a promissory note. The application form, among other things, provides for the following:

a. amount of money borrowed by applicant at Federal Reserve Bank and elsewhere;

b. authorization of the Federal Reserve Bank to charge the amount of the advance to the account of the borrowing bank any time after the date of the advance if written on demand or at maturity if written on time;

c. description and face amount of collateral offered to secure the advance.

The present policy at the Federal Reserve Bank of Boston is to permit a loan value of par for municipal securities.

The Federal Reserve Bank of Boston has been able to pass credit to the borrower on the same day as the application was received, as all of its loans of this type have been secured by high-grade, readily-marketable bonds.

At the present time the basic law and Regulation A, issued by the Board of Governors of the Federal Reserve System, are being reviewed with the objective of increasing the flexibility of Federal Reserve Bank lending arrangements.

The major changes proposed in the Regulation are with reference to collateral securing borrowing from the Federal Reserve Banks. As indicated above, the Act provides for loans to member banks for appropriate purposes secured by U.S. Government obligations or by eligible paper which may be made at the discount rates in effect at the various Reserve Banks. The current changes in the law, if approved by the Congress, will eliminate the technical requirements regarding eligible paper from the Federal Reserve Act.

The revision contemplates that, subject to the Board's regulations, member bank borrowing from a Federal Reserve Bank need simply be secured by assets satisfactory to the Federal Reserve Bank, and all such borrowings will be at the discount rate.

Proposed Revision of Discount Window Administration

On July 15, 1968, the Federal Reserve published a System report entitled, "Reappraisal of the Federal Reserve Discount Mechanism," the result of an intensive three-year study of Federal Reserve lending policies. While the report reaffirms the three long-established principles of Federal Reserve lending policy, it proposes several significant changes in lending policies and procedures aimed at providing more liberal and clear-cut access to the discount window. If these proposals are adopted, the discount window may play a more active part in enabling commercial banks to meet their communities' credit needs more effectively.

To provide more clear-cut access to the discount window, the report proposes that each soundly-operated member bank have a "basic borrowing privilege," enabling it to automatically borrow limited amounts of funds from its Reserve Bank for a specified number of weekly reserve periods.

The report further provides for seasonal credit accommodation for member banks with large seasonal swings in excess of a specified minimum.

Member banks would not be limited to borrowing under the terms of these proposals, but additional borrowing would be subject to essentially the same administrative policy and procedure now applied to member banks.

A final major new idea proposed by the report is to make the discount rate more flexible than in the past. The report recommends that the discount rate be changed more frequently to keep it closely in line with movements in other money market rates.

A copy of the report may be obtained by writing the Federal Reserve Bank of Boston, Public Information Department.

COMMENTS AND CONCLUSIONS

This study has attempted to better acquaint bankers with the procedures of "money market instruments" and to show how excess reserves may be employed most effectively.

Most large banks assign one of their officers, generally a vice president, the responsibility of maintaining the reserve position. His desk is generally referred to as the "money desk." One of the principal responsibilities of the man at the money desk is the establishment of a system throughout his bank whereby all significant transactions that affect the money position are reported to him immediately. Such transactions would include large transfers into or out of customers' accounts, large purchases or sales of securities for account of customers or in or out of the bank's portfolio, transfers in or out of the Treasury Tax and Loan account or sizeable new loans, or maturities and rebates of outstanding loans. All of these factors are of vital interest to the money desk, as they constitute the principal data used to gauge the reserve position of the member bank.

There is no practical need for member banks to carry with the Federal Reserve Bank more than the prescribed requirements. On occasion, when reserve balances at the Federal Reserve increase to amounts in excess of requirements and in excess of current needs, such funds can be profitably employed in very short-term investments or sold to a bank that needs them. Since reserve requirements are averaged over a seven-day period, there is no legal need to keep more than the amount necessary to average out over the period. The Federal Reserve Banks have no interest in excess balances above those required by the regulation.

As indicated above, the fastest and most convenient method of employing or acquiring funds is through the Federal Funds market.

However, it must be borne in mind that there will be occasions when funds are not offered or available, and likewise when no institution is seeking to buy funds.

Assuming a bank has difficulty in adjusting its position through the Federal Funds market, the next most popular method is the Treasury Bill market. Because of the widespread use (since 1948) of Federal Reserve wire facilities in the purchase and sale of government securities, with its advantages of payment in immediately available Federal Funds, the dealers and banks insist upon making trades payable in Federal Funds. A bank may buy or sell Treasury Bills and receive credit for the sale, or pay for and commence accuring earnings on the same day the trade is made. Treasury Bills are called "near money" for the above reasons.

The hypothetical case cited strongly indicates that the person assigned to the bank's money position is not employing the excess reserves. For the seven-day reserve period ended January 7, 1970, his bank on a daily basis averaged $105,400 in excess of requirements. If the above funds were employed, either in Federal Funds or Treasury Bills, and the rate of return was 8 percent, it would have resulted in earnings of $163.96, or approximately $8,525.92 if the excess were continued for a full year. The bank under discussion is a relatively small bank with total deposits of about $30 million.

In conclusion then, it appears reasonable to suggest that those bankers who are not now familiar with money market instruments would do well to review their use in connection with efficient management of their money position, with a view to employing safely all excess funds in order to maximize earnings.

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