BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



April 26, 1960.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Young

With further reference to the proposed reply to the letter from the Under Secretary of the Treasury dated April 13, 1960, regarding cash refunding, there is enclosed a copy of a revised draft of letter that takes account of informal discussions of this matter since April 22. It is planned to include this topic, including discussion of the proposed reply to the Treasury, on the agenda for the meeting of the Federal Open Market Committee to be held at 10:00 a.m. on Tuesday, May 3, 1960.

Very truly yours,

Ralph A. Young

Ralph A. Young, Secretary,
Federal Open Market Committee.

Enclosure

DRAFT



Dear Julian:

Your letter of April 13, 1960, requests the views of the Federal Open Market Committee on an enclosed circular under which refunding securities would be offered for either cash or maturing securities, but no special subscription privilege would attach to maturing securities. In the event of over-subscription, there would be allotments. Although it is not so stated in the circular, your letter states that you contemplate that subscriptions from the Federal Reserve System, Government investment accounts, and all subscriptions up to a minimum amount would be allotted in full. In subsequent oral discussions you indicated that it is the intention of the Treasury to allot in full all subscriptions, irrespective of the amount, made by certain other subscribers who would constitute a substantial group, including, for example, State and local governments, foreign governments, foreign central banks, international institutions, and publicly administered pension funds.

The question arises whether, under such a refunding offer, the Federal Reserve acquisitions of the refunding securities would be "acquired directly from the United States" within the purview of section 14(b) of the Federal Reserve Act, which provides that "the aggregate amount . . . of obligations acquired directly from the United States which is held at any one time by the twelve Federal Reserve banks shall not exceed $5,000,000,000."

A substantially similar proposal was presented by the Treasury for the Committee's consideration in early October 1958. It differed

from the present proposal only in that (1) the offering of identical securities to the Federal Reserve System on a full-allotment basis was referred to separately in the Treasury circular, and (2) the full-allotment privilege may have been confined to the Federal Reserve System. In a letter dated October 21, 1958, the Committee took the position that acquisitions by the Reserve Banks pursuant to such a refunding arrangement would not constitute a direct acquisition from the United States within the meaning of section 14(b).

Although the Committee's letter did not so state, the Committee strongly questioned the advisability of a debt management move that would distinguish in any way between the securities held by the Federal Reserve Banks and the securities held by other investors, and with your letter of October 24, 1958, you suggested a modified proposal under which there would be no difference in any respect in the treatment accorded the Federal Reserve System as compared with any other investor. To that proposal, the Committee responded that it had concluded that acquisitions by the Reserve Banks pursuant to such a refunding would not be subject to the $5 billion limit stated in section 14(b) of the Federal Reserve Act and that, subject, of course, to usual questions regarding monetary and credit policy and the terms eventually set for the refunding security, the Federal Reserve Banks would be prepared to consider refunding some or all of their maturing securities under such a proposal.

The Committee has reviewed the proposal in your letter of April 13, as modified by your oral statement referred to above, and has concluded that, like the arrangements proposed in October of 1958,

acquisitions by the Federal Reserve Banks pursuant to such a refunding would not be subject to the $5 billion limit stated in section 14(b) of the Federal Reserve Act. Furthermore, since it is contemplated that a substantial group of other investors would be eligible to refund on the same basis as the Federal Reserve Banks, the objection to the first proposal made in 1958 would not seem to apply. Accordingly, subject to usual questions regarding monetary and credit policy and the terms eventually set for the refunding security, the Federal Reserve Banks would be prepared to consider refunding some or all of their maturing securities under such a proposal.

Sincerely yours,

Wm. McC. Martin, Jr.

The Honorable Julian B. Baird,
Under Secretary of the Treasury,
Treasury Department,
Washington 25, D. C.