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

June 16, 1970.

To: Federal Open Market Committee

From: Arthur L. Broida

Enclosed for your information and records are (1) a copy of a memorandum from the System Account Manager dated June 11, 1970, and entitled "Terms and Conditions for Lending Securities from System Open Market Account," and (2) a copy of the revised form of securities loan agreement now in use.

Enclosure.

To: Members of Federal Open Market Committee and Presidents of the Federal Reserve Banks not presently on the Committee.

June 11, 1970

From: Alan R. Holmes
Manager
System Open Market Account

Subject: Terms and Conditions for Lending Securities from System Open Market Account

Reflecting our experience in lending System Account securities to dealers, the terms and conditions for such lending have been changed as outlined in my discussion of this subject at the meeting of the Committee on March 10, 1970. Revisions have been made only in the terms relating to lending to dealers in connection with delivery failures. As no loans have yet been made in connection with securities clearance arrangements, there is no basis for suggesting changes in the terms and conditions covering such loans. The new terms follow, with notes to indicate how they have been changed.

Loans to Government Securities Dealers
in Connection with Delivery Failures

1. The borrower will be required to certify that he is borrowing the securities to fulfill a contract to deliver the securities on a particular day, in circumstances where he is reasonably certain that the securities will not be available for delivery that day, even though he had expected they would be available; that he is reasonably certain they cannot be borrowed from other sources and that the securities are not to be used in connection with a short sale.

Comment:

The earlier version required unqualified certification that securities were not available and could not be borrowed from other sources. The revised version requires only "reasonable" certainty since it is not possible for borrowers to be absolutely certain. Copy of revised contract containing the certification is attached.

2. Securities may be loaned for periods not to exceed five business days. Loan contracts may be renewed only when, in the judgment of the Federal Reserve, circumstances exist which justify renewal. Any renewals will be subject to the same terms and conditions as the original contracts, except that the rate of interest may be increased as noted in #5 below.

Comment:

Loan period is extended from two to five business days to give dealers a better chance to work out the more difficult fail problems.

3. Securities may be loaned up to the following limits:

a) Treasury bills--up to $50 million total par value to any one dealer in one transaction.

b) Coupon issues--up to $10 million par value to any one dealer in one transaction.

c) Total outstanding to any one dealer at any one time not to exceed $150 million par value.

Comment:

The limit on total lending to one dealer has been raised from $75 million to $150 million to allow for possible greater borrowing needs of the larger, more active dealers.

4. The borrower will be required to pledge collateral consisting of United States Government securities of greater current market value than the securities borrowed, and the collateral may be acquired by the System Open Market Account or sold in the market in the event the borrower does not make timely return of the borrowed securities in accordance with the provisions of the contract.

5. The borrower will be charged interest on the principal amount (par value) of the securities borrowed at the following rates:

Initial charge for 5-day loan	3/4	percent
First renewal of one day	1 1/2	"
Second renewal of one day	3	"
Third renewal of one day	4 1/2	"
Subsequent renewals	6	"

The Federal Reserve will have the option of waiving or reducing penalty rates if the circumstances appear to warrant it.

Comment:

Establishes a schedule of penalty renewal rates.

6. If the securities are not returned on time and a renewal is not granted, the borrower will be charged

interest on the principal amount of securities borrowed at the rate of 6 percent per annum per day (including the day the securities should have been returned) until the securities are returned or the collateral sold.

Loans to Participants in Securities Clearing Arrangements in which a Federal Reserve Bank Participates

1. The Fiscal Agency function of the Federal Reserve Bank conducting the arrangement will certify that one of the banks participating in the arrangement is unable to deliver certain Government securities needed to settle the clearing.

2. Securities may be loaned for not more than one business day and must be returned the following business day. Loan contracts may be renewed only when, in the judgment of the Federal Reserve Bank, circumstances exist which justify a renewal. Any renewals will be subject to the same terms and conditions as the original contracts, except that a penalty rate may be charged at the discretion of the Federal Reserve Bank.

3. The amounts of securities to be loaned will be subject to no fixed limits but will be determined by the Reserve Bank in consultation with the Federal Reserve Bank of New York.

4. The borrower will be required to pledge collateral consisting of United States Government securities of greater current market value than the securities borrowed and the collateral may be acquired

by the System Open Market Account or sold in the market in the event the borrower does not make timely return of the borrowed securities in accordance with the provisions of the contract.

5. The borrower will be charged interest on the principal amount of the securities borrowed at the rate of 3/4 percent per annum per day until the timely return of the securities, except that the borrower may be charged a penalty rate on renewals at the discretion of the Federal Reserve Bank.

6. If the securities are not returned on time and a renewal is not granted, the borrower will be charged interest on the principal amount of the securities borrowed at the rate of 6 percent per annum per day (including the day the securities should have been returned) until the securities are returned or the collateral sold.

SECURITIES LOAN AGREEMENT

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

Gentlemen:

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

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

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

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

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

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

We hereby certify that we are borrowing the abovementioned securities in order to fulfill our obligation under a contract to sell and deliver such securities today, in circumstances where we are reasonably certain that such securities will not be available for delivery, even though we had expected they would be available, and we are reasonably certain they cannot be borrowed from other sources. We also certify that such securities are not to be used in connection with a short sale.

Yours very truly,

(Official signature)