



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

July 16, 1974

TO: Federal Open Market Committee

FROM: Arthur L. Broida *ALB*

Attached is a copy of a report by Governor Wallich on
the July Governors' Meeting in Basle.

Henry C. Wallich
July 16, 1974

Report on the BIS Governors' Meeting - July 8, 1974

In place of the usual survey of country problems, the following issues received fairly intensive discussion:

- (1) Guidelines or rules for liquidity, solvency, and for exchange exposure of banks.
- (2) Lender-of-last-resort responsibilities.
- (3) Redepositing of reserves by central banks in the Eurodollar market.
- (4) The Herstatt failure.
- (5) (at the dinner meeting) Possible use of OPEC funds by the BIS.

(1) Guidelines

Gordon Richardson described the approach of the Bank of England as focusing principally upon the quality of management. Within this context, the Bank of England, he said, judges the adequacy of a bank's free reserves and its liquidity ratio. The Bank obtained detailed data on the maturity structure of Eurocurrency operations each quarter, which so far had shown no unsatisfactory trend. Failure to maintain adequate liquidity in terms of asset-liability structure leads to a discussion of the Bank of England with the individual bank. As regards foreign exchange positions, the Bank of England sets individual limits on the open position against sterling for each bank, as well as on the position of spot

against forward. No limits are placed on positions in currencies other than sterling, but this might have to be explored in future.

Clappier (France) indicated that France had tight control over its banks but that foreign currency transactions still remained in part uncontrolled. The Bank of France is working with the commercial banks on an information procedure covering the foreign currency position as well as the relation between the maturity structure of assets and of liabilities. Commercial banks are interested in and receive the resulting composite information on a voluntary basis.

Vandeputte (Belgium) said that Belgian controls over the capital ratios of banks had become more lenient in recent years. The spot and forward position in each currency for each bank was watched by the authorities. Controls are maintained only on the over-all open position in Belgian francs but not for each currency.

Zijlstra, Richardson, Clappier, and Vandeputte expressed an interest in developing more information on exchange positions and in possibly coordinating this information internationally.

(2) Lender-of-Last-Resort Function

Richardson laid out in detail what he considered proper policy with respect to particular banks.

(a) For British banks the Bank of England would assume full responsibility if it considered support to be justified.

(b) For consortium banks, he saw no way of assigning responsibility but hoped that the prestigious banks participating in the consortium banks would stand back of their subsidiary.

(c) For wholly or majority owned foreign subsidiaries, the Bank of England would feel a certain responsibility to enlist support to insure a healthy banking system within its own country. This responsibility would be met, however, by seeking to enlist the help of the central bank of the majority shareholder.

(d) In cases where the difficulties experienced were in dollars, Richardson hoped that assistance would be forthcoming from the Federal Reserve if the amounts in dollars required proved an embarrassment to the Bank of England.

Klasen (Germany) agreed with Richardson's assignment of responsibility to central banks as lender of last resort in cases where assistance was justified. He entered general reservations, however, regarding the appropriateness of assistance.

I pointed out that it was difficult to generalize about lender-of-last-resort responsibilities, referring to the difference between liquidity and solvency problems, between branches and subsidiaries, to problems of availability of collateral, of the degree of supervision that a foreign central bank could exercise over branches and subsidiaries of its banks abroad, and of the supervision and regulation applied by the host country authorities. I added

that a central bank had to be strongly conscious of its responsibilities as lender of last resort but that these had to be viewed also in the context of whether the problem was a macro or a micro problem, whether the need was to provide liquidity for a whole market or to bail out a particular institution, and how a rescue operation could be reconciled with the over-all needs of monetary policy.

(3) Redepositing in the Eurodollar Market

Several representatives, especially those of England, Italy, and Holland, suggested that the "self-denying ordinance" not to place central bank reserves back into the Eurodollar market might have to be lifted. Their objective apparently was to increase the lending power of the Eurodollar market, reflecting a concern that a growing proportion of the OPEC money will flow to New York. Klasen spoke against the proposal. His concern was with the inflationary consequences of this redepositing, which in effect creates additional Eurodollars. I supported him on the same grounds and also by pointing out that it is not attractive for the U.S. to find that other countries in effect are creating dollars which could give rise to lender-of-last-resort responsibilities. No clear decision was reached on this matter.

(4) Herstatt Failure

Klasen described the circumstances leading to the decision to close the Herstatt bank. He regretted the losses suffered by American banks, which, he said, were shared by German banks, but

absolved the German authorities from responsibility. Wallich and Coombs argued that the world payment mechanism was affected by the failure and that the liquidity of some American banks was affected by the delays that had had to be imposed on the clearing mechanism in order to guard against further losses. Failure to undo the damage to American banks, Coombs said, would lead the market to regard spot purchases and sales of exchange as credit transactions and would slow the mechanism as well as hurt small banks trying to deal in spot exchange. No strong complaints were voiced by European central bankers, contrary to expectations, about the slowing of the clearing mechanism in New York.

(5) BIS Recycling of OPEC Funds

At the dinner meeting, Zijlstra spoke of the possibility that the BIS might soon receive very substantial OPEC funds, and examined the terms on which the BIS could accept and relend these. The principles he set forth, which were not universally endorsed, involved (a) no active solicitation of funds on the part of BIS, (b) the need for the BIS to obtain guidance on the political decision involved in choosing among potential borrowers, and (c) the need of the BIS for guarantees by the EEC or a wider group against losses. Zijlstra's discussion of the prospects of such a deal was not sufficiently precise to permit this possibility to be built into any particular assistance package that might have to be discussed outside the BIS in the near future.