



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

March 8, 1977

CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida *ALB*

Attached are memoranda relating to the annual review of System lending of securities, from the Deputy Account Manager dated March 4, and from the Committee's General Counsel dated March 8. It is contemplated that these memoranda will be discussed at the next meeting of the Committee.

Attachments

CONFIDENTIAL (FR)
CLASS II - FOMC

March 4, 1977

TO: Federal Open Market Committee
SUBJECT: Recommendation on System Lending of Securities
FROM: Peter D. Sternlight

Attached is a statistical report on the lending to dealers of securities held in the System Open Market Account since the last annual meeting of the Federal Open Market Committee in March 1976. The report indicates a moderate increase in the dollar volume of loans made by the Desk, while the number of loans showed a small decline.

It is not at all surprising that the dealers increased their borrowing from the Desk during a period which experienced heavy Treasury financing operations and one in which the volume of trading in Treasury securities by reporting dealers increased by about 75 percent, from approximately \$6.0 billion (daily average) in 1975 to a remarkable \$10.5 billion (daily average) in 1976. The fact that the Desk's lending operation grew much more moderately than total trading activity probably reflected the abundance of securities available for lending from other sources, and also the dealers' continued effort to locate new and reliable sources of lendable securities.

At the same time, the record volume of trading last year is no doubt largely responsible for a sharp increase in the volume of temporary delivery failures; fails to receive securities increased by about 50 percent and dealers' fails to

deliver securities increased about 36 percent. In my judgment, expansion of failures in the market does not reflect a deterioration in back-office operations at dealer firms or problems with the automated clearing mechanism for Government securities, but is a direct result of the extraordinary volume of trading. The fail situation nevertheless remains a source of concern to the Trading Desk, as a considerable deterioration in that situation could significantly impede the functioning of the Government securities market.

The System's lending operation, which is the ultimate and most dependable source of lendable securities, helped to prevent the fail situation from becoming much worse, and thus it continues to be necessary to the effective functioning of the market in which the Desk conducts System open market operations. Accordingly, Mr. Holmes and I recommend that the Committee renew the authorization to lend securities for another year.

The overall operation continues to be profitable, with earnings for the New York Bank in 1976 amounting to \$1,978,409, an increase of about 25 percent from 1975. Estimated expenditures needed to run the lending operation amounted to less than 10 percent of earnings.

Attachment

Statistics on Federal Reserve
Lending of Securities

	<u>Mar. 1975 through Feb. 1976</u>	<u>Mar. 1976 through Feb. 1977</u>	<u>Percentage Change</u>
Number of Loans	9,868	9,653	- 2 %
Total Amount	\$17,891	\$20,789	+ 16 %

Daily Averages

Number of Loans	40	38	- 5 %
Amount	\$ 72.1	\$ 82.8	+ 15 %
Balance Outstanding	\$131.1	\$144.4	+ 10 %
Size of Each Loan	\$ 1.8	\$ 2.2	+ 22 %

Dealer Fail Statistics

	<u>1975</u>	<u>1976</u>	<u>Percentage Change</u>
Daily Average Fails to Receive	297	446	+ 50 %
Daily Average Fails to Deliver	229	312	+ 36 %

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It is my opinion that the Committee could find that the continued lending of securities from the System Account to dealers and clearing banks is reasonably necessary for the effective conduct of open market operations, and that the continued lending of System securities, as authorized by the Authorization for Domestic Open Market Operations, is within the "incidental powers" of the Reserve Banks.