

To Federal Open Market Committee

February 28, 1961

From Robert G. Rouse and
John R. Farrell

SUGGESTED CLARIFICATION OF
STATEMENT OF PROCEDURE FOR ALLOCATING
SYSTEM OPEN MARKET ACCOUNT

REC'D IN RECORDS SECTION

MAR 2 - 1961

In the general reallocation of the System Open Market Account on April 1, 1960, it developed that the Federal Reserve Banks of Atlanta and Minneapolis, because of low reserve ratios, were unable to take all of the additional participation in the Account to which they were entitled according to the new allocation ratios based on the average total assets of the various Reserve Banks for the year ended February 29, 1960. Accordingly, pursuant to Section 3 of the statement of procedures for allocating the Account, the allocations were adjusted to prevent the reserve ratios at the Atlanta and Minneapolis banks from dropping below 35 per cent as a result of the reallocation. Apportionment of the Account subsequent to the reallocation has been made according to the adjusted ratios established at that time. However, the question has been raised as to whether the subsequent distribution throughout the year on these adjusted ratios is in accordance with the statement of procedures.

From the adoption of the new allocation formula in 1953 up to April 1960, there was no need for adjusting the ratios at the annual reallocation because the reserve ratios at all banks were above 35 per cent. However, since the reserve ratios are now lower than they were one year ago, it is likely that some adjustments will be necessary in connection with the general reallocation on April 1, 1961. It would, therefore, be helpful to have the Federal Open Market Committee clarify the procedure as to the distribution of the Account subsequent to the reallocation.

Relevant Sections 3, 4, 5 and 6 of the statement of procedure now read as follows:

3. No allocation shall be made which would reduce the reserve ratio of a Bank as of the next to the last business day of March below 35 per cent. If, because of the provisions of this paragraph, a Bank is unable to take its pro rata share based on total assets, the amount which it is unable to take without reducing its reserve ratio below 35 per cent shall be allocated to the Bank or Banks having the highest reserve ratios in such a manner that the ratio of the Bank or Banks to which securities are reallocated will not be reduced below the ratio of any other Bank. Regardless of possible subsequent improvement in reserve ratios, no reversal of these adjustments shall take place pending the next general reallocation.
4. Increases and decreases in total amount held in the Account shall be apportioned on the basis of the ratios computed for the latest general reallocation.
5. If a Bank's reserve ratio falls below 30 per cent on the next to the last business day (as observed by the Agent Bank) of a statement week or month, sufficient of its holdings as of the close of business that day to raise its reserve ratio to 35 per cent shall be reallocated by an adjustment the following day, unless such day is a general reallocation date. Such securities shall be allocated to the Bank or Banks having the highest reserve ratios.

(NOTE: This procedure does not contemplate partial reversal of these adjustments. However, full reversal of these adjustments will be made when a Bank's reserve position improves to the extent that the full amount of its participation allocated to other Banks under the provisions of this paragraph can be restored without reducing the Bank's reserve ratio below 35 per cent.)

6. If a Bank's reserve ratio should fall below 30 per cent on any other day, or if a Bank anticipates that its reserve ratio will fall below that figure, it may arrange with the Manager of the Open Market Account to make an adjustment similar to those provided for in paragraph No. 5 so as to increase the Bank's reserve ratio to 35 per cent.

Some misunderstanding may arise from the wording of Paragraph 4. It may not be clear whether the ratios referred to in that paragraph are the total assets ratios as originally computed for reallocation purposes or the total assets ratios as adjusted to prevent reserve ratios from falling below 35 per

cent. Paragraph 4 also might be misleading because it is the practice to apply these ratios to the total par value holdings of the various issue groups, rather than to the increases or decreases in the Account.

In order to clear up any possibility of misinterpretation, it is RECOMMENDED that Section 4 be revised to read as follows:

4. The Account shall be apportioned during the ensuing twelve months on the basis of the total assets ratios computed for the latest general reallocation after allowing for any adjustments as provided for in Paragraph 3, unless there shall be further adjustments described in Paragraphs 5 or 6.

Under this rule the apportionment of the System Account will be made on the same set of ratios throughout the year, as it has been from April 1960, unless of course there is a need for an adjustment pursuant to Paragraph 5 or 6. Even though these adjusted assets ratios would not be the same as the total assets ratios, we would not consider this inequitable since the allocation formula is arbitrary in any case. We believe this interpretation to be consistent with one of the objectives of the Committee when the new procedures were adopted in 1953.