



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

February 8, 1977

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida *ALB*

Attached is a memorandum from the Subcommittee on Agency Issues dated January 28, 1977, and entitled "Recommendations regarding agency issues purchased by the Desk."

It is contemplated that this memorandum will be discussed at the forthcoming meeting of the Committee.

Attachment

CONFIDENTIAL (FR)
CLASS II FOMC

DATE: January 28, 1977

TO: Federal Open Market Committee
FROM: Subcommittee on Agency Issues
[Messrs. Coldwell, Gardner and
Volcker (Chairman)]

SUBJECT: Recommendations
regarding agency issues
purchased by the Desk.

In response to questions raised at the November FOMC meeting Chairman Burns appointed our Subcommittee to "consider the list of agency issues purchased by the Desk and to make recommendations". The Subcommittee reviewed the System's portfolio, examined the Desk's policy for choosing the agency securities purchased, and considered the circumstances attending the Committee's 1971 decision to commence outright operations in agency securities. A background memorandum discussing these matters is attached.

The Subcommittee has unanimously concluded that the Committee's present guidelines for operations in securities of Federally owned or sponsored agencies could usefully be changed.^{1/} The System has acquired, under the present guidelines, the securities of a number of agencies which have few issues outstanding, or which have no prospect for issuing securities to the market on a continuing basis. In our judgment, future purchases of such securities should be ruled out.

After considering the merits of several alternative means to meet this objective, the Subcommittee concluded that the Desk

^{1/} The current set of guidelines is appended to this memorandum.

should restrict its purchases to securities of agencies which are not eligible to borrow from the Federal Financing Bank (FFB). In practice, at present, this would mean restricting purchases to securities of government sponsored agencies; it would make ineligible the securities issued or guaranteed by agencies wholly or partly owned by the Federal Government. However, the System would be able to buy the securities of the FFB itself, should the FFB market its own issues rather than finance its operations through direct borrowing from the Treasury as has been recent practice.^{2/}

Under this recommendation, the Desk would at present confine its agency purchases to the non-government guaranteed securities of the Federal Home Loan Banks, Federal National Mortgage Association, Federal Land Banks, Federal Intermediate Credit Banks and the Banks for Cooperatives.^{3/} The Desk would no longer purchase securities of the General Services Administration, Postal Service, Washington Metropolitan Area Transit Authority, Eximbank, Farmers Home Administration, and Government National Mortgage Association. None of these agencies now issues securities in the market (except for GNMA pass-through mortgage-backed securities). With that exception, these agencies now finance through the FFB and presumably

^{2/} Paragraph 1(a) of the Authorization for Domestic Open Market Operations authorizes the Desk "to buy or sell U.S. Government securities, including securities of the Federal Financing Bank"

^{3/} The Federal Home Loan Mortgage Corporation has four non-government guaranteed issues outstanding in the market which would be technically eligible, but the Desk has not purchased any of these securities pending evidence of an active secondary market.

will continue to do so. We contemplate that the System portfolio would retain present holdings of securities of those agencies no longer eligible for purchase until maturity -- or unless such securities were sold, in response to attractive bids, in the course of a routine sale of agency issues for purposes of reserve management.

There are several considerations that commend this approach. First, it would, in effect, distinguish as eligible for System purchase the securities of the "established" Federally-sponsored agencies, which were among those that the Congress intended the System to buy when the enabling legislation was passed in 1966. Since the agencies with access to the FFB no longer issue securities in the market, System purchases of outstanding issues of these agencies would provide no assistance to the objectives these agencies might foster, or to the basic objective of the legislation authorizing System purchases of agency issues in terms of encouraging a satisfactory market climate for agency financing. Also, the approach is consistent with the view that agency financing should be on the ordered, supervised, and lower cost basis which has been promoted by the FFB. The Federal Reserve System was an early supporter of the concept of a Federal Financing Bank and should continue to encourage the Federal agencies to borrow at the lowest cost under centralized Federal supervision. One practical consequence would be to eliminate purchases of special or local purpose securities which have been a source of concern to some Committee members.

The recommended approach could be implemented by revising the first sentence of guideline number 4 to read "Purchases will be

limited to fully taxable issues, not eligible for purchase by the Federal Financing Bank, for which there is an active secondary market".

Publication of the revised guideline might lead to some criticism because it appears to narrow the scope of System activity. However, it should be possible to deal with such criticism by explaining that the change reflects the de facto agency financing situation with the FFB in place; that it tends to encourage more orderly agency financing; and that it would still permit System recognition of agency programs through System purchases of FFB issues (in the event they issue their own paper).

The action recommended would not hamper the Desk's ability to affect bank reserves through agency operations; as noted, none of the agencies that would be excluded now finances in the market, and the Desk's leeway to purchase additional amounts of their outstanding securities is not large in any event.^{4/}

If other Federally sponsored agencies are created in the future, the proposed new guideline would not necessarily resolve satisfactorily questions about the appropriateness of Desk purchases of their securities. But that kind of question would arise whether or not the proposed change is adopted.

Attached are two tables. The first lists System holdings by agency and indicates the Desk's leeway to purchase additional

^{4/} An exception to this generalization is the case of GNMA pass-through securities, which are eligible for the FFB but which are nevertheless sold in the market; however, the Desk has not yet purchased these securities as it has not determined that these issues fall within the Committee's intended scope of System operations.

securities. Shown separately are securities not eligible for FFB (and hence remaining eligible for System purchase under the proposed revision of guideline 4), and securities eligible for FFB (which would no longer be eligible for System purchase under the proposed change). The second table lists outstanding borrowing at the Federal Financing Bank.

In its consideration of the list of agency issues purchased by the Desk, the Subcommittee also gave some attention to other aspects of the guidelines. While no proposals are being made to the Committee at this time, and these matters were not clearly within the frame of reference of the Subcommittee, some question was raised in the Subcommittee's deliberations as to the appropriateness of the present size limitations for issues eligible for purchase and the percentage of such issues the System might properly hold. These questions are being reviewed by the System Account Management for possible recommendations in the future.^{5/} The Subcommittee would be glad to review such recommendations if the Committee so desires.

Attachments

^{5/} The Desk is currently limited to purchasing issues outstanding in amounts of \$300 million or over in cases where the obligations have a maturity of five years or less at the time of issuance, and to issues outstanding in amounts of \$200 million or over in cases where the securities have a maturity of more than five years at the time of issuance. This guideline was given to encourage the agencies to sell issues of a size which would foster an active secondary market. Agency offerings of new securities today are nearly always in amounts larger than the guideline limitations. Also, System holdings of any one issue cannot exceed 30 percent of the amount of the issue outstanding and aggregate holdings of the issues of any one agency cannot exceed 15 percent of the amount of outstanding issues of that agency.

TABLE I

Federal Agency Securities
System Holdings
December 31, 1976
(in millions of dollars)

Desk Leeway
to Purchase
Add'l Secs.
based on 15%
of outstanding
issues of the
Agency

	<u>System Holdings</u>	<u>Issues Outstanding</u>	<u>Desk Leeway to Purchase Add'l Secs. based on 15% of outstanding issues of the Agency</u>
<u>Securities Not Eligible for FFB</u>			
Banks for Cooperatives	78	4,330	572
Federal Intermediate Credit Banks	414	10,494	1,160
Federal Land Banks	946	17,127	1,623
Federal Home Loan Banks	1,762	16,811	760
Federal National Mortgage Association	<u>2,840</u>	<u>30,358</u>	<u>1,714</u>
Subtotal	6,040	79,120	5,829
<u>Securities Eligible for FFB</u>			
Farmers Home Administration	295	7,990	904
Export-Import Bank	118	2,293*	226
Washington Metropolitan Area Transit Authority	117	845	10
Government National Mortgage Association, Participation Certificates	90	4,145	532
Postal Service	37	250	-0-
General Services Administration	14	678	88
Federal National Mortgage Ass'n/GNMA**	59	200	1**
Federal Home Loan Mortgage Corp./GNMA***	<u>24</u>	<u>2,050</u>	<u>81</u>
Subtotal	754	18,451	1,842
TOTAL	6,794	97,571	7,671

* Includes only debentures, p.c.'s and state and local government issues.

** Mortgage-backed bonds guaranteed by GNMA -- leeway is based on 30 percent of the amount of this issue.

*** Mortgage-backed bonds guaranteed by GNMA. Only one issue is eligible for purchase -- leeway is based on 30 percent of the amount of this issue.

OFFICE CORRESPONDENCE

DATE December 15, 1976To Mr. VolckerFROM E. J. Ozog SUBJECT: Background Material for a
Review of the System's Portfolio of Agency
Securities.

The purpose of this memo is to review the composition of the System's portfolio of agency securities and to consider -- in light of questions raised at the Federal Open Market Committee meeting on November 15, 1976 -- which agency securities are appropriate for the System's portfolio. Since the System began acquiring agency securities on an outright basis in September 1971 the System Account Management has decided which agencies should be purchased on the basis of the Federal Reserve Act and the guidelines provided by the FOMC. Neither the Act nor the guidelines are specific regarding the question of what agencies issue securities appropriate for the System's portfolio. (Guidelines attached)

In constructing a portfolio of agencies, the Desk has considered that it is appropriate, in accord with the Federal Reserve Act, to purchase any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States -- provided, in accord with the FOMC guidelines, such an obligation has been issued in a sufficient amount, is a fully taxable obligation, and enjoys an active secondary market. On the basis of such principles the Account Management has constructed a portfolio of agency securities which include obligations of not only the traditional market borrowers such as the FIB, FICB, COOP, FHLB, and FNMA but less prominent participants such as the Postal Service, General Services Administration and the Washington Metropolitan Area Transit Authority. On the other hand, securities

such as National Power Corporation bonds (EXIM guaranteed), Federal Home Loan Mortgage Corporation Guaranteed Mortgage Certificates, and Government National Mortgage Association Modified Pass-through securities have not been purchased because they have not been deemed to meet the FOMC's guidelines mainly because an active secondary market does not exist or the securities have characteristics which make them unsuitable instruments for open market operations.

A review of the events surrounding the FOMC's decision to commence outright operations in agencies helps in understanding Desk operations. Prior to September 21, 1966 the Federal Reserve Banks had legal authority to buy and sell only agency obligations which were fully guaranteed by the United States. While the Fed could buy issues of minor market borrowers such as Eximbank, Federal Housing Administration and some other agencies, it could not purchase the securities of major borrowers such as the Federal Home Loan Bank and the Federal National Mortgage Association. Because of Congressional concern for the credit needs of housing, in particular, Congress gave the Fed the power to buy any obligation which is a direct obligation of any agency of the United States by adding paragraph (2) to Section 14(b) of the Federal Reserve Act. During the week ended December 7, 1966 the Fed arranged repurchase agreements against agency securities but the revised authority to deal in agencies was not used on an outright basis for about five years.

In the late 1960's, there was extensive study of whether the System should hold agency securities on an outright basis. Staff studies and Committee discussion leading to the August 1971 decision to begin outright operations focused on several considerations including the following:

- 1) A desire to respond to Congressional sentiment in favor of System participation in the agency market without involving the Fed in support of particular agencies or interests.

- 2) A need to commence operations in agencies on a modest, experimental basis, given the technical problems involved and the lack of System experience in the market.
- 3) The desire of the Government to bring some order to the financing of agency operations, a goal which eventually produced the Federal Financing Bank.
- 4) The need to provide the System Account manager with a tool of open market operations which would be useful in affecting bank reserves, money market conditions and monetary aggregates.

At the April 1971 meeting of the FOMC the staff presented the Committee with a memorandum on the subject of agency operations which included pro and con arguments and a proposed set of guidelines for operations. At the meeting, the Chairman said that after considering the question at some length he personally had concluded that it probably would be desirable for the System to undertake such operations. However, the Chairman thought the Committee should postpone action on the matter because the Treasury was about to propose legislation that would permit the consolidation of the issues of various Federal agencies (Federal Financing Bank Act), and in the Treasury's judgment a System decision to undertake outright operations in such issues at that time would damage the chances that legislation would be enacted.

In a memorandum to the Chairman dated July 26, 1971, Arthur Broida stated that while Congress had not yet had the opportunity to consider the legislation in question, several considerations had combined to suggest that it might be desirable for the Open Market Committee to reach a final decision on outright operations in agency issues relatively soon. The considerations were, in summary, that it would be desirable to rectify any mistaken conclusion that the System lacks concern for housing and that initiation of System operations in issues

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of the larger agencies, might improve the climate for the Treasury's legislation (Federal Financing Bank). Mr. Broida advised that "the Treasury's earlier concern that System operations in agencies would damage chances of enactment of the proposed legislation might be alleviated by the fact that under the present form of the bill there probably would not be a great deal of overlap between the agency issues subject to consolidation and those in which the System would be operating. This is because the issues of the major agencies -- including FNMA, the Federal Home Loan Banks, and those in the Farm Credit System --- would not be eligible for purchase by the proposed Federal Financing Bank; whereas, under the guidelines most recently considered by the Open Market Committee, the bulk of System operations would be in the issues of these agencies".

At its next meeting, August 24, 1971, the Committee voted to conduct outright transactions in Federal agency securities announcing the decision on September 16, 1971. The overlap between the Federal Financing Bank and System purchases turned out to be greater than foreseen in August 1971. At that time only Eximbank and GNMA (FNMA) participation certificates, accounting for about 20 percent of the total dollar volume of outstanding agency securities, would be eligible for purchase by both the System and the Federal Financing Bank. However, the Federal Financing Bank was not established until December 1973 and by that time a number of additional agencies which qualify for the Federal Financing Bank began to sell in the market. They included the Postal Service, General Services Administration, the Washington Metropolitan Transit Authority, and at an expanded pace, the Farmers Home Administration.

The Desk purchased the securities of the new entrants because their securities met the FOMC's guidelines and the market looked on these securities as being within the boundaries of the agency market. The decision to purchase these agencies also considered the FOMC's guideline that purchases are not designed to

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channel funds into issues of particular agencies. If the Desk avoided these agencies, and thereby did not treat each agency objectively, it may have appeared that agency operations were largely aimed at channeling funds to the agencies on whose behalf there was political pressure being exerted.

The Desk's decision to purchase every agency meeting the FOMC's guidelines regardless of the agency's form, operations or purpose for borrowing, seemed appropriate when System operations were "experimental" but the Desk now has five years of experience and the Committee may want to consider a revision in its guidelines. While it may be difficult to generalize about the agency issues, as each one has unique features as to purposes, involvement of the "private sector" in the decision-making of the agency, the nature of government backing of the security and specific details regarding the securities issued, it does seem possible to distinguish some agencies, or their securities, as being relatively unusual. The Washington Metropolitan Area Transit Authority (WMATA) is an example of an unusual agency which the System has in its portfolio. This agency can better be described as an enterprise which has issued bonds related to a Federal program. The WMATA was created by a compact between Maryland, Virginia and the District of Columbia for the purpose of developing and operating a rail rapid-transit system. The authority had the privilege of selling tax-exempt bonds to finance its project, as does any other local government authority, but apparently at the suggestion of investment bankers and the recommendations of the Treasury with the approval of Congress, WMATA sold taxable bonds which were guaranteed by the U.S. Government. The financing was arranged at a time when there was active consideration of the concept of taxable municipal bonds subsidized by the Federal government. The WMATA is provided with a Treasury subsidy to help defray the added expense of having sold bonds which are subject to Federal taxation. The WMATA now borrows from the Federal Financing Bank. This example illustrates the difficulty the Desk

faces when a new agency enters the market. While WMATA is not a typical agency it did enter the market for the purpose of furthering a concept which is not as narrow in purpose as the name Washington Metropolitan Area Transit Authority would imply.

Nevertheless, it is possible that in the future more esoteric forms of Federal agencies will enter the market and the System may want to be in a position to judge on an objective basis whether they are appropriate vehicles for open market operations. Following are various options which may help define what agencies are appropriate.

1. Maintain Present Policy

The Committee could elect to continue to operate under the present guidelines. This option recognizes that in their present form the guidelines provide an acceptable approach to an amorphous financial sector. Acceptance of this option would mean, however, that the System could in the future acquire obligations which are only nominally "agency" issues, possibly controversial in nature and of the kind which may lead the System to involvement in undesirable fields of activity.

Nevertheless, the guidelines as now constituted provide protection against the System being pressured to engage in undesirable activity. The Desk can hold only 15 percent of any agency's marketable obligations, a limitation which was designed to avoid the fact or appearance of undue "support" or "channeling" of funds. The guidelines also call for eligible issues to have a reasonably active secondary market. This requirement can help the System avoid issues or agencies which are not accepted by the market or which are not homogenous with other agencies.

The guidelines now allow the System to follow an objective "market approach", i.e., the Desk does not engage in value judgements. The Desk purchases obligations which are defined as Federal agency obligations and meet the test of

feasibility for managing reserves. It can be argued that the System need not be concerned with the purpose of the obligation it acquires as long as that obligation is acquired in the normal, competitive operations it now conducts in the market. The System should only be concerned over the danger of falling into operations which are unrelated to reserve management or broad market considerations. It does not seem to follow that holding the obligations of a questionable "agency" would force the System into agency "support" operations. It may be realistic to argue that purchasing moderate amounts of all agencies which meet our present guidelines generates less exposure than a policy which attempts to discriminate. The present guidelines have the advantage of being accepted while at the same time being general enough to allow the System to decide appropriateness for inclusion in its portfolio.

2. Avoid issues eligible for Federal Financing Bank

The Committee could elect to purchase only those agencies which are not eligible for financing through the Federal Financing Bank (FFB). This option recognizes that when the Committee authorized outright operations in agencies the prospective formation of the FFB was a significant element in its deliberations. Because the FFB legislation was not passed until two years after System purchases began, it may be fair to say that it is largely circumstantial that there is now a considerable overlap between what agencies are held by the System and the FFB.

It should be considered that there was a need to bring order to the agency market in the early 70's; the number of agencies financing in the market was proliferating and there was inadequate government supervision of agency financing. The System supported the concept of the FFB and should continue to encourage it. It enables Federal agencies to borrow at a lower cost than they could by individually entering the market-place and it centralizes and coordinates Agency financing.

The FFB is authorized to lend to departments and agencies of the Government and to Government-guaranteed borrowers. It also purchases agency loan assets. Under such authorizations it has already financed seventeen borrowers including the GSA, P.S., WMATA, FHDA, and EXIM, five agencies which are also found in the System's portfolio. New York City seasonal financing has found its way into the FFB because Treasury loans to New York City have been sold to FFB.

The proposal to purchase the securities of borrowers who have no access to financing through the FFB has the advantage of advocating a System policy which should work to the benefit of the borrower and should not be particularly controversial. However, the System does presently hold \$778 million, out of an agency portfolio of \$6.9 billion, in securities which seem to be eligible for purchase by the FFB. Close to 80 percent of these securities are due in more than five years with maturities extending to 2014. If the FOMC decided it was desirable to no longer hold these securities it would be difficult to sell those securities in the market over a short period of time. There may be a possibility that the FFB would have interest in them but the Desk does not have authority for such a transaction. Of course, an FOMC decision to discontinue new purchases of agency issues eligible for purchase by FFB would not necessarily require the System to sell its current holdings of such issues.

In order to effect this option, the first sentence of FOMC guideline Number 4 could be expanded to read "Purchases will be limited to fully taxable issues, not eligible for purchase by the Federal Financing Bank, for which there is an active secondary market."

3. Agencies Active in the Market

The Committee may wish to purchase only the securities of agencies which are currently selling debt in the market. This option would, in effect, also restrict purchases to the securities of issuers who are not eligible for borrowing

at the FFB. If this option was adopted the outstanding securities of issuers such as WMATA, GSA, P.S., and FHDA would no longer be purchased since these agencies now finance at the FFB. A disadvantage of this option is that it offers no protection against unusual agency securities which may be sold in size and frequency in the future but which the FOMC may consider inappropriate for the System portfolio. This option also involves difficulties of interpretation. For example, the Eximbank finances at the FFB but does from time to time guarantee and sell securities known in the market as agency securities.

In order to implement this option the FOMC would have to modify its guidelines. To do this it is suggested that Guideline 4 be expanded to read, "Purchases will be limited to fully taxable issues of agencies actively marketing securities and for which there is an active secondary market".

4. Established Agencies

The Committee may want to deal only in securities of agencies which have extensive marketing experience and an established name in the market. The Desk could consider whether an agency was established on the basis of the number of years of experience the agency has had in bringing issues to market, the amount of its obligations outstanding and the number of issues it has sold. The Desk could require an agency to have marketed securities over a period of say, five years, have \$1.5 or \$2 billion outstanding, and possibly seven or eight issues.

This option could be considered simply a refinement of the FOMC's guideline to buy only issues for which there is an active secondary market. An active secondary market is a function of the tradable supply and homogeneity of the security. It may be argued that only an established agency which has brought a sizeable supply of issues to the market can be said to have created the conditions necessary for an active market. Similarly, an agency which has sold issues which are not homogeneous with other agency securities will diminish the probability of an active secondary market for its securities.

This proposal has the advantage of not requiring a change in the guidelines. The major disadvantage is that the essence of the proposal is a strict definition of active secondary market inconsistent with past Desk practice. The strict definition does not seem to be widely accepted.

5. Broad-Purpose Agencies

The Committee may wish to consider that as a Federal entity, the System should purchase agencies whose borrowings are used to serve broad purposes which are national in scope. Agencies which serve narrow purpose or particular regions could be considered inappropriate for the portfolio of a Federal organization.

A change in purchasing policy along these lines would not be advisable mainly because it would involve the Committee in value judgements which should be avoided. The System should not have to decide whether an agency is borrowing for the right purposes, a decision which is similar to those of credit allocation.

Federal Agency Securities
System Holdings
November 30, 1976
(in millions of dollars)

	<u>System Holdings</u>	<u>Issues Outstanding</u>	<u>Desk Leeway to Purchase Add'l Secs. based on 15% of issues outstanding</u>
COOP	78	4,207	553
FICB	413	10,669	1,187
FLB	946	17,127	1,623
FHLB	1,763	16,806	758
FHLMC	24	2,050	284
FNMA	<u>2,938*</u>	<u>30,413</u>	<u>1,624</u>
Subtotal	6,162	81,272	6,029
FHDA	295	8,280	947
EXIM	142	3,580	395
WMATA	117	845	10
GNMA PC's	90	4,145	532
PS	37	250	-0-
GSA	<u>14</u>	<u>687</u>	<u>89</u>
Subtotal	695	17,787	1,973
Total	6,857	99,059	8,002

* Includes \$59 million mortgage backed bonds guaranteed by GNMA.

Attachments

cc: Messrs. Holmes, Guy, Sternlight, Meek, Sandberg, Ms. Tschinkel, Clarkin, Mr. Hill

October 6, 1966.

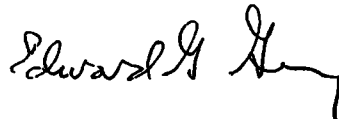
CAPSULE ON THE BOARD'S LETTER DATED SEPTEMBER 30, 1966
WITH RESPECT TO PUBLIC LAW 89-597 EMPOWERING THE FEDERAL
RESERVE BANKS TO BUY AND SELL AGENCY ISSUES

Page 1 of Schedule A lists the Board's letter dated September 30, 1966 relating to certain provisions of Public Law 89-597, approved September 21, 1966, extending the range of securities that Federal Reserve Banks may buy and sell, under direction of the FOMC, in the open market to include obligations issued or guaranteed by an agency of the United States. Prior to the enactment of this provision, Reserve Banks could buy and sell only agency obligations in the open market which were fully guaranteed by the United States. These included certain obligations of the Eximbank, Federal Housing Administration, Commodity Credit Corporation and the Maritime Administration. The bulk of these and the other eligible agency issues, however, did not include the major agency issues traded in the market.

The principal agency issues in terms of aggregate size and market activity are Federal Intermediate Credit Bank debentures, Bank for Cooperatives debentures, Federal Home Loan Bank notes and bonds, Federal Land Bank bonds, Federal National Mortgage Association debentures and certificates of participation. Aside from certain short-term Federal Intermediate Credit Bank obligations, none of these issues have been eligible for System transactions but all are now eligible for purchase and sale under the provisions of the new law.

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The Board's letter of September 30 notes that regardless of whether or not the Federal Open Market Committee decides to initiate operations in agency issues the new provisions appear to expand the authority of the Reserve Banks to make advances to member banks using agency issues as collateral. The letter states that in view of past rulings of the Board under which certain of the agency issues would be ineligible, the Board expects to reconsider its position in this connection under the new law.

A handwritten signature in cursive script, appearing to read "Edward G. King". The signature is written in dark ink and is positioned to the right of the main text block.



Public Law 89-597
89th Congress, H. R. 14026
September 21, 1966

An Act

To provide for the more flexible regulation of maximum rates of interest or dividends payable by banks and certain other financial institutions on deposits or share accounts, to authorize higher reserve requirements on time deposits at member banks, to authorize open market operations in agency issues by the Federal Reserve banks, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Banks.
Interest rates,
controls.

SECTION 1. The Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board, in implementation of their respective powers under existing law and this Act, shall take action to bring about the reduction of interest rates to the maximum extent feasible in the light of prevailing money market and general economic conditions.

RESERVES AND RATE CEILINGS—MEMBER BANKS

SEC. 2. (a) Section 19 of the Federal Reserve Act is amended by striking the first six paragraphs (12 U.S.C. 461, 462, and 462b) and inserting: 40 Stat. 239.

“(a) The Board is authorized for the purposes of this section to define the terms used in this section, to determine what shall be deemed a payment of interest, and to prescribe such regulations as it may deem necessary to effectuate the purposes of this section and to prevent evasions thereof.

“(b) Every member bank shall maintain reserves against its deposits in such ratios as shall be determined by the affirmative vote of not less than four members of the Board within the following limitations:

“(1) In the case of any member bank in a reserve city, the minimum reserve ratio for any demand deposit shall be not less than 10 per centum and not more than 22 per centum, except that the Board, either in individual cases or by regulation, on such basis as it may deem reasonable and appropriate in view of the character of business transacted by such bank, may make applicable the reserve ratios prescribed for banks not in reserve cities.

“(2) In the case of any member bank not in a reserve city, the minimum reserve ratio for any demand deposit shall be not less than 7 per centum and not more than 14 per centum. 80 STAT. 823
80 STAT. 824

“(3) In the case of any deposit other than a demand deposit, the minimum reserve ratio shall be not less than 3 per centum and not more than 10 per centum.

“(c) Reserves held by any member bank to meet the requirements imposed pursuant to subsection (b) of this section shall be in the form of—

“(1) balances maintained for such purpose by such bank in the Federal Reserve bank of which it is a member, and

“(2) the currency and coin held by such bank, or such part thereof as the Board may by regulation prescribe.”

(b) The paragraphs which, prior to the amendments made by this Act, were the seventh (12 U.S.C. 374a), eighth (12 U.S.C. 374, 463), ninth (12 U.S.C. 464), tenth (12 U.S.C. 465), eleventh (12 U.S.C. 466), twelfth (12 U.S.C. 371a), and thirteenth (12 U.S.C. 371b) paragraphs of section 19 of the Federal Reserve Act are respectively redesignated as subsections (d), (e), (f), (g), (h), (i), and (j) of that section.

Pub. Law 89-597 - 2 - September 21, 1966

(c) Such section is further amended by striking the first sentence of subsection (j) as redesignated (12 U.S.C. 371) and inserting: "The Board may from time to time, after consulting with the Board of Directors of the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, limit by regulation the rates of interest which may be paid by member banks on time and savings deposits. The Board may prescribe different rate limitations for different classes of deposits, for deposits of different amounts or with different maturities or subject to different conditions regarding withdrawal or repayment, according to the nature or location of member banks or their depositors, or according to such other reasonable bases as the Board may deem desirable in the public interest."

49 Stat. 715;
12 USC 371b;
Ante, p. 824.

(d) The last paragraph of such section (12 U.S.C. 462a-1) and the proviso in section 8 of the Second Liberty Bond Act (31 U.S.C. 771) are repealed.

Repeal.
49 Stat. 715.
40 Stat. 504.

RATE CEILINGS—INSURED NONMEMBER BANKS

SEC. 3. The second and third sentences of section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) are amended to read as follows: "The Board of Directors may from time to time, after consulting with the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board, limit by regulation the rates of interest or dividends that may be paid by insured nonmember banks (including insured mutual savings banks) on time and savings deposits. The Board of Directors may prescribe different rate limitations for different classes of deposits, for deposits of different amounts or with different maturities or subject to different conditions regarding withdrawal or repayment, according to the nature or location of insured nonmember banks or their depositors, or according to such other reasonable bases as the Board of Directors may deem desirable in the public interest."

64 Stat. 893.

RATE CEILINGS—SAVINGS AND LOAN ASSOCIATIONS

SEC. 4. The Federal Home Loan Bank Act is amended by adding after section 5A thereof (12 U.S.C. 1425a) the following new section:

"SEC. 5B. The Board may from time to time, after consulting with the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation, limit by regulation the rates of interest or dividends on deposits, shares, or withdrawable accounts that may be paid by members, other than those the deposits of which are insured in accordance with the provisions of the Federal Deposit Insurance Act, and by institutions which are insured institutions as defined in section 401(a) of the National Housing Act. The Board may prescribe different rate limitations for different classes of deposits, shares, or withdrawable accounts, or with different maturities or subject to different conditions regarding withdrawal or repayment, according to the nature or location of such members or institutions or their depositors, shareholders, or withdrawable accountholders, or according to such other reasonable bases as the Board may deem desirable in the public interest."

64 Stat. 257.
80 STAT. 824
80 STAT. 825
64 Stat. 873.
12 USC 1811 note.
48 Stat. 1255.
12 USC 1724.

OUTSTANDING RATE REGULATIONS

SEC. 5. Any regulation prescribed by the Board of Governors of the Federal Reserve System or the Board of Directors of the Federal Deposit Insurance Corporation with respect to the payment of deposits and interest thereon by members banks or insured nonmem-

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ber banks which is in effect when this Act is enacted shall continue in effect unless and until it is modified or rescinded after consultation with the Board of Directors or the Board of Governors, as the case may be, and the Federal Home Loan Bank Board.

OPEN MARKET OPERATIONS

SEC. 6. Section 14(b) of the Federal Reserve Act (12 U.S.C. 355) ^{38 Stat. 265.} is amended by inserting "(1)" immediately after "(b)" and by adding the following new paragraph at the end:

"(2) To buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States."

SEC. 7. The provisions of the preceding sections of this Act shall be effective only during the one-year period which begins on the date of enactment of this Act. Upon the expiration of such period, each provision of law amended by this Act is further amended to read as it did immediately prior to the enactment of this Act.

Approved September 21, 1966.

LEGISLATIVE HISTORY:

HOUSE REPORT No. 1777 (Comm. on Banking & Currency).

SENATE REPORT No. 1601 (Comm. on Banking & Currency).

CONGRESSIONAL RECORD, Vol. 112 (1966):

Sept. 7: Considered in House.

Sept. 8: Considered and passed House.

Sept. 15: Considered and passed Senate.

Effective June 17, 1975

**GUIDELINES FOR THE CONDUCT
OF SYSTEM OPERATIONS IN FEDERAL AGENCY ISSUES**

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.
2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.
3. System holdings of agency issues shall be modest relative to holdings of U. S. Government securities, and the amount and timing of System transactions in agency issues shall be determined with due regard for the desirability of avoiding undue market effects.
4. Purchases will be limited to fully taxable issues for which there is an active secondary market. Purchases will also be limited to issues outstanding in amounts of \$300 million or over in cases where the obligations have a maturity of five years or less at the time of issuance, and to issues outstanding in amounts of \$200 million or over in cases where the securities have a maturity of more than five years at the time of issuance.
5. System holdings of any one issue at any one time will not exceed 30 per cent of the amount of the issue outstanding. Aggregate holdings of the issues of any one agency will not exceed 15 per cent of the amount of outstanding issues of that agency.
6. All outright purchases, sales and holdings of agency issues will be for the System Open Market Account.