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The Federal Reserve Bank of New York (FRBNY) announced today a number of measures intended by the Federal Open Market Committee (FOMC) to promote the smooth functioning of money and financing markets and to gain greater assurance that the FRBNY will be able to manage banking system reserves during the period around the century date change. These measures recognize the potential for reserve needs to be elevated during the fourth quarter and into the new year when there also may be heightened demands for, and thus an effectively reduced supply of, the collateral that the Federal Reserve currently accepts in its repurchase transactions. The measures include the expansion of collateral accepted in repurchase transactions, the extension of the maximum term of the FRBNY’s repurchase transactions to 90 days, and the introduction of a Standby Financing Facility.

Expansion of Collateral Accepted by FRBNY in Repurchase Transactions

The FOMC voted, at its August 24 meeting, to approve a temporary expansion of the securities eligible as collateral in the repurchase transactions undertaken by the FRBNY in the management of banking system reserves. The principal effect of this expansion will be the inclusion of pass-through mortgage securities of GNMA, FHLMC and FNMA, STRIP securities of the U.S. Treasury and “stripped” securities of other government agencies. In order to gain access to this larger pool of securities, the FRBNY will be establishing custody arrangements with commercial banks to manage the clearing and settlement of collateral on a “tri-party” basis. The tri-party arrangements are expected to be in place in early October, permitting the introduction of the broader pool of collateral at that time. The acceptance of a broader range of collateral will improve the FRBNY’s ability to address expanded reserve needs that are now anticipated for the fourth quarter.

The expansion of collateral was approved only through April 2000. The FOMC intends to review its experience with the broader range of eligible collateral and tri-party arrangements prior to this date.

Authorization to Execute Repurchase Transactions with Maturities up to 90 Days

The FOMC voted, at its August 24 meeting, to authorize the FRBNY to enter into repurchase transactions with maturities of up to 90 days. Previously, it had authorized the FRBNY to arrange repurchase transactions of up to 60 days. This will bring the FRBNY’s term repurchase operations into alignment with market practice and will also facilitate the FRBNY’s provision of banking system reserves consistent with the pattern of demand that is now expected during the fourth quarter. This change is permanent.

Standby Financing Facility: Options on Repurchase Agreements

The FOMC also voted, at its August 24 meeting, to authorize the FRBNY to provide a temporary Standby Financing Facility (SFF) through the auction of options on temporary transactions. Under this authority, the FRBNY plans to sell options on overnight repurchase agreement transactions for exercise on specific days in December 1999 and January 2000. The SFF is intended to provide greater assurance that there will be sufficient depth and liquidity in short-term funding markets to permit the FRBNY and other market participants to undertake needed year-end adjustments in balance sheets through transactions in financing markets. The FRBNY will sell the options to its regular counter parties in open market operations, the primary dealers, with the intent of facilitating greater overall market making in money and financing markets around the turn of the year.

The FRBNY’s current intention is to auction the options competitively at three strike prices, each of which is at a defined spread to the FOMC’s target Fed funds rate. A strike price at a spread of 150 basis points over the target funds rate is under consideration, as well as two additional strike prices at wider spreads to the target funds rate, on individual option contracts valued at $50 million. Dealers will be able to exercise the options on specific days, most likely covering the last two weeks of December and the first two weeks of January. Thus, a dealer that purchases an option for a specific date on a repurchase transaction at a strike price of 150 basis points over the FOMC’s then-prevailing target Federal funds rate would be able to exercise the option on that day and secure financing of approximately $50 million of eligible securities at the contracted rate. By providing this form of “insurance” against the risk that market rates could move widely from their normal ranges, the SFF is expected to encourage normal intermediation and arbitrage around the turn of the year. More normal markets, in turn, should reduce the demand for highly liquid assets and reserves and provide the FRBNY with better market conditions in which to adjust the quantity of reserves, thereby helping to ensure that the Federal Reserve will be able to meet its objectives and carry out its responsibilities through the century date change period.

The amounts available for auction, the number of days over which auctions will take place, the number of exercise days, the number of alternative strike prices and other terms of the SFF will be determined by the FRBNY after discussions with the primary dealers and other market participants. The FRBNY also plans to discuss with the primary dealers and other market participants the benefits of selling options on matched sale-purchase transactions. A discussion draft of the proposed terms of the SFF is attached. The FRBNY invites comments on the discussion draft and anticipates completing final terms of the SFF by the end of September.

The SFF is a temporary facility that will be available only through January 2000.

Contact: Douglas Tillett