COMMENTS BY BOARD OF GOVERNORS ON REPRESENTATIVE PATMAN'S TESTIMONY OF FEBRUARY 7, 1958 BEFORE HOUSE BANKING & CURRENCY COMMITTEE

Section 4 of the Act provides that "every Federal reserve bank shall be conducted under the supervision and control of a board of directors," and sets forth both the composition and manner of election or appointment of such boards. It further specifies that "the board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law."

Section 11 authorizes the Board to exercise general supervision over the Federal Reserve Banks; other fundamental powers which the Act confers on the Board include the authority to liquidate or reorganize a Federal Reserve Bank (Section 11), and to readjust or create new districts--not to exceed twelve in all (Section 2).

Congress provided for an accounting by the Board of Governors of its stewardship over the Federal Reserve System by requiring (Section 10) that the Board "shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress."

The responsibilities placed upon the Boards of Directors of the individual Reserve Banks, and the Board of Governors, must be taken into account when considering expenditures and practices upon which Mr. Patman has commented.

Section 21 of the Federal Reserve Act provides that the Board shall at least once a year order an examination of each Federal Reserve Bank. With regard to the scope of the examinations, the Board's instructions to its examiners contain the following general provisions:

> "The examination of a Federal Reserve Bank shall determine (a) its financial condition through appraisal of its assets and verification of its assets and liabilities, including liabilities as custodian, without undue duplication of effective and acceptable verifications made through the Reserve Bank's own audit procedure; (b) proper discharge of its responsibilities as Fiscal Agent of the United States; and (c) compliance by the management with applicable provisions of law, regulations of the Board of Governors, and any other applicable requirements. Also the Board's examiners shall develop pertinent facts and opinions which will enable the Board of Governors to appraise the condition, operations, and administration of each Reserve Bank."

Pursuant to these instructions, the examination reports contain--along with detailed schedules of assets, liabilities, and reserves--a wide variety of information and comments. Some of these comments are of a critical nature; others are in the form of suggestions as to operating procedures; and still others pertain to matters which the examiners feel may be of interest to the Board or should be made a matter of record.

Upon the conclusion of each examination, the examiner presents his report to the President, and the Chairman of the Board of Directors of the Reserve Bank, at which time the examiner's suggestions and criticisms are fully discussed. The report is then reviewed by the Board of Governors, and advice is requested from the Bank concerning matters that seem to warrant further attention. Copies of these reports covering years as far back as 1949 have on previous occasions been furnished to the House Banking and Currency Committee.

Last August Mr. Patman requested copies of the reports of examinations made by the Board's examiners during the five-year period 1952-1956. That portion of Mr. Patman's statement of February 7 which concerns expenditures and operations of the Federal Reserve Banks was based on these reports.

Insurance

On Page 1549 Mr. Patman stated that during the year 1956 the Federal Reserve Banks spent $1,821,429 for insurance (as shown on Page 1666, this total should be $1,128,429), and asked: "Why should the Federal Reserve banks buy insurance?" His statement continued: "This insurance is unneeded . . . with all the money and resources of the Federal Reserve System, if it can not carry the risk of its own insurance, then certainly there is no private insurance company that can carry this risk."

The Federal Reserve Banks have discontinued purchasing substantial amounts of insurance. About 15 years ago the Banks, with the encouragement of the Board, entered into a loss-sharing agreement under which they discontinued the purchase of registered mail insurance for their own account and reduced the Bankers' Blanket Bond coverage at each Bank to $500,000. Each year the Reserve Banks set aside a portion of their earnings (at the rate of two cents per thousand dollars of value of shipments covered) as a reserve for registered mail losses. At the end of 1956 this reserve totaled approximately $10 million.

The question of purchased insurance has been considered from time to time, particularly the possible desirability of extending the coverage of the loss-sharing program of the Reserve Banks. For various reasons, extensions of this program to risks other than mentioned above were considered undesirable or impracticable. For example, a program of loss-sharing in lieu of Workmen's Compensation insurance would necessarily have to comply with the laws of each of the States in which the Federal Reserve Banks have employees. Administration of such a program would require expert technical

knowledge on personal injury and insurance matters, such as investigation and settlement of claims, with respect to which Federal Reserve personnel have had little or no experience.

A breakdown of the $1,128,429 which the Federal Reserve Banks spent for insurance in 1956 is shown in the table on Pages 1665-1666. As this table indicates, about $750,000 of the total represented the Banks' portion of premiums paid for hospital and medical service insurance, and about $150,000 was for Workmen's Compensation insurance.

"Unusual Expenses"

Mr. Patman's statement mentioned (pages 1562-1584) numerous items under the heading "Unusual Expenses." These items include expenditures for the following purposes: Personnel activities including training, recreation, loan funds, and employee insurance; Membership dues; Charitable activities; Meetings and entertainment; and Buildings and land.

Except for the "Buildings and land" category, all of the above reflect operating policy decisions at the individual Reserve Banks. The Board has taken the position that the responsibility for determining whether expenditures of this nature are necessary expenses within the meaning of Section 7 of the Federal Reserve Act rests primarily with the officers and directors of the individual Banks. This position is consistent with the provisions in Section 4 of the Federal Reserve Act that "every Federal reserve bank shall be conducted under the supervision and control of a board of directors" and that the"directors shall perform the duties usually appertaining to the office of directors of banking associations."

The Board of Governors relies upon its examiners to review all such expenditures and bring those about which there may be any question to the attention of the Bank's management and to the attention of the Board.

More specific comments with regard to these matters are given below:

Personnel activities

The fact that employees of the Federal Reserve Banks are not Government employees is particularly important when considering personnel programs. The Reserve Banks must compete in the local labor market and, if they are to compete successfully, their personnel programs must be in line with those of the community.

The Federal Reserve Clubs, which Mr. Patman referred to on several occasions, are employee organizations which sponsor social, recreational, and educational programs. Allotments to them are part of the per capita cost which the Reserve Banks budget for their personnel activities.

To a large extent the efficiency of the operations of a Reserve Bank depends upon the experience and stability of its staff. In this light, the real measure of personnel activities is their effect on reduced turnover and greater efficiency, rather than the direct cost of the various activities.

Membership dues

Mr. Patman commented (page 1564) that the Federal Reserve Banks "pay dues and assessments to the American Bankers Association, the American Institute of Banking, the private clearing houses, the chambers of commerce, and others, and pay officers' and employees' fees and expenses for attending meetings of such organizations."

Among the organizations mentioned were, "private clearing houses." Memberships in local Clearing House Associations greatly expedite the presentation by the Federal Reserve Banks of checks drawn on local banks. Membership dues are levied by these associations to pay their operating and administrative expenses. In some cases, the Reserve Banks pay such dues; in other cases they provide the Clearing House with operating space in the Reserve Bank building and are accordingly relieved from the payment of dues. One advantage of the latter arrangement is that it eliminates the need to transport through the streets each day the great volume of local checks received by the Reserve Banks.

Memberships in such organizations as the American Bankers Association, chambers of commerce, etc., reflect--like personnel activities--operating policy decisions at the individual Reserve Banks. The over-all guiding principle in connection with such memberships is that they should be confined to organizations falling within one or more of the following

categories:

1. Organizations whose activities are directly related to the work of the Reserve Bank, such as national and State bankers' associations.

2. Organizations in which the Reserve Bank feels it should be represented, such as chambers of commerce and appropriate financial and agricultural associations.

3. Organizations in which membership is desirable in order to obtain publications and other services, such as economic and other professional associations.

Memberships in the first two categories permit regional soundings and a blending of views that constitute one of the most important strengths of the Federal Reserve System. They form a means of economic intelligence that enables the Reserve Banks to obtain and transmit to appropriate authorities in the System information concerning rapidly occurring changes in our economy, and are directly relevant to the timely formulation of credit policy.

Although it feels that individual decisions with respect to memberships should be determined at the local level, the Board has devoted considerable attention over the years to the general question of expenditures for membership dues. The most recent review of this matter, begun in the latter part of 1956, resulted in discontinuance of certain memberships carried at Bank expense.

Meetings and entertainment

In this category Mr. Patman cited from the examination reports comments concerning the following matters:

Cleveland 1952

Expenditures of $295 for stateroom for two officers in connection with annual lake cruise sponsored by the

Cleveland Chamber of Commerce.

Expenses of $5,417 for joint meeting of Boards of Directors of the main office and the Pittsburgh and Cincinnati Branches at Cincinnati, including $165 for favors, $184 for a river trip, and $190 for entertainers.

Boston 1953

Reimbursement of expenses ($158) incurred by officers as a result of attendance of their wives at meetings of State bankers associations.

Minneapolis 1953

Entertainment expenses of $50 in connection with Annual Conference of Personnel Officers of Federal Reserve Banks; and entertainment expenses of $150 in connection with a conference of Ninth District Bank Examiners.

Kansas City 1953

Expenses totaling $1,773.70 incurred in connection with a Conference of Bank Supervisors and Examiners, including $325 for entertainers.

St. Louis 1954

Expenditure of $419.68 for 86 theater tickets purchased for entertainment in connection with November 12, 1953 joint meeting of Boards of Directors of the head office and the three branches.

Expenditures of $157.25 for 85 baseball tickets; and of $99.75 for 57 theater tickets purchased for entertainment in connection with June 10, 1954 joint meetings of Boards of Directors of the head office and the three branches.

These tickets were for the use of the directors and officers of the Reserve Bank and their wives.

Minneapolis 1955

Expenses of (a) $100 for entertainers in connection with an Examiners' Conference; (b) $62.40 for basketball tickets and $60 for Ice Follies tickets purchased for entertainment in connection with various sessions of the "Short Course in Central Banking" during the period January 1 - July 1, 1955; (c) $72 for dinner music entertainment for April 1955 "Directors and Officers Assembly"; and (d) $76.40 for 21 football tickets in connection with the October 1955 Directors' meeting.

Dallas 1956

Expenditure of $100 for entertainment during dinner given to delegates from all Federal Reserve Banks attending National Convention of American Institute of Banking.

The above expenditures were in connection with business meetings of direct interest or benefit to the Reserve Banks. They were considered by the management of the individual Bank concerned to be reasonable and appropriate for the occasion. In each case, however, after the matter was made a subject of comment in the examination report, the Bank reviewed its policy and subsequently discontinued incurring expenses of the type questioned.

Buildings and land

On page 1571 the following statement by Mr. Patman appears:

> "These banks (the Reserve Banks) are supposed to be limited by law in their spending for bank premises. They

> are expressly forbidden to build or enter into any contract to erect any building to cost in excess of $250,000 without coming to Congress for the authorization."

This statement is incorrect in two respects. First, the limitation in the law applies to branch buildings, not to head office buildings. Secondly, the limitation cited is that originally enacted June 3, 1922, and ignores subsequent amendments.

The full text of the limitation is found in paragraph 9 of Section 10 of the Federal Reserve Act, which reads as follows:

> "No Federal reserve bank shall have authority hereafter to enter into any contract or contracts for the erection of any branch bank building of any kind or character, or to authorize the erection of any such building, if the cost of the building proper, exclusive of the cost of the vaults, permanent equipment, furnishings, and fixtures, is in excess of $250,000: Provided, That nothing herein shall apply to any building under construction prior to June 3, 1922: Provided further, That the cost as above specified shall not be so limited as long as the aggregate of such costs which are incurred by all Federal Reserve banks for branch bank buildings with the approval of the Board of Governors after the date of enactment of this proviso does not exceed $30,000,000."

Mr. Patman's statement continued: "But the Federal Reserve System has invented a new accounting system which seems to eliminate much of the normal inconvenience of any restraint on capital outlays. By this new system, they simply charge capital outlays to current expense."

The examples cited with respect to the charge of construction costs to current expense (page 1575) refer to repairs and alterations at head office buildings. The basic principle followed in such charges is to capitalize those which add to the intrinsic value of the property, and to charge to expenses the costs of repairs and alterations which keep the properties in repair and make for efficient utilization of space and operations but do not add new intrinsic values to the building. This is in accordance with standard accounting practice.

Much of the material concerning Bank premises which is contained in Mr. Patman's statement represents merely comments by the Board's examiners with respect to the progress of building projects at various Federal Reserve Banks and branches. Mr. Patman cited several instances of parking arrangements provided for Bank employees. These arrangements are similar to those provided here in Washington for employees of Government departments.

Losses and Discrepancies

On page 1575, Mr. Patman stated:

> "Some of the losses and the discrepancies in the accounts of the Federal Reserve Banks are truly amazing. All of these banks experience tremendous losses of registered mail containing deposits, securities and other things of value. They charge off or set up reserves amounting to millions of dollars for such losses."

The implied criticism of the practice of setting up reserves against possible registered mail losses seems to conflict with the earlier assertion (page 1549) that the Federal Reserve System should carry its own insurance. As mentioned previously, the Federal Reserve Banks do have a registered mail loss-sharing agreement, and--as part of this program--set aside a portion of their earnings each year as a reserve against possible losses.

The record does not support the assertion regarding losses and discrepancies at the Reserve Banks. In the light of the tremendous volume of money, checks and securities handled by the Reserve Banks--losses and discrepancies have been exceedingly small and infrequent.

The following data indicating the volume of currency, checks and securities which the Federal Reserve Banks handle in one year were taken from the table on page 79 of the Board's 1956 Annual Report.

1956 volume of--	Millions of pieces	Billions of dollars
Currency received and counted 1/	4,467	29
Checks handled--		
Government	539	114
All other	2,822	1,005
Issues, redemptions and exchanges of U. S. Government securities	199	422

1/ Does not include new money received from Washington.

In contrast to the above amounts which are in billions of dollars, the following figures showing net losses at all Reserve Banks due to differences and registered mail losses, during the years covered by Mr. Patman's statement, are in actual dollars.

	Net Losses charged to	
	Profit and Loss-- Difference account	Reserve for registered mail losses
1952	$16,239	$1,150
1953	11,907	1,140
1954	9,325	150
1955	9,097	965
1956	7,112	100

Note--The total of about $3,500 charged to the Reserve for Registered Mail Losses during the five years 1952-56 resulted from the loss-sharing agreement of the Federal Reserve Banks. It may be of interest to mention that during the same period this agreement also resulted in a savings of more than $2 million in premiums that the Reserve Banks would have paid if, in lieu of the loss-sharing program, they had purchased insurance to cover their shipments of currency, coin and securities.

In several cases, the losses which Mr. Patman cited were beyond the responsibility of the Reserve Banks and were included in the examination report only as a matter of information. For instance, on page 1578, Mr. Patman commented on an $85,000 currency shipment by the Federal Reserve Bank of New York which was embezzled by a Post Office employee.

The quotation from the examination report clearly indicates that the embezzler was an employee of the Post Office Department, and that most of the money was recovered. In the light of these facts it is obvious that there was no negligence or culpability on the part of the Reserve Bank in connection with the incident.

Moreover, certain of the larger items which Mr. Patman listed under the general heading "Losses and Discrepancies" do not belong in such a category. They pertain to Deferred Accounts, Reserves for Contingencies, and other such schedules which are necessary in the examination report to show the detail of the Bank's assets, liabilities and reserves. They do not represent, or indicate, losses or discrepancies.

For example, on page 1576 there is listed from the 1954 Examination Report of the Federal Reserve Bank of San Francisco an amount of $51,883,221.62 which is shown under Deferred Accounts as "Uncollected cash items--Due from member and nonmember banks." This amount, of course, represents checks and other cash items which the Reserve Bank forwarded for collection and for which, in the normal course of business, payment had not yet been received as of the date of the examination. It is in no sense a loss or a discrepancy.

Cafeteria Subsidy

On page 1584, Mr. Patman's statement includes the following remarks:

> "They make generous subsidies to the employees' cafeterias and dining rooms. The Board has authorized the banks to pay up to one-half of the costs. As previously pointed out, the total cost of all the cafeterias in 1956, according to the bank's method of computing these costs, came to $2,549,099, and of this amount the banks paid $1,196,814, while the cafeterias receipts took care of $1.3 million. (See pt. I, p. 569, of the hearings.)

> "I do not object to a fair subsidy for restaurants and cafeterias in connection with a business. I think it is pretty well accepted practice. But I think it is very unusual for the Government to have to pay 50 per cent of such expenses, and even more. Furthermore, these audit reports disclose that even the theoretical maximum of 50 per cent is an understatement."

He adds (on page 1585) that "it would appear that the cost of overhead--bank space, lights, water, all the expensive equipment and the dining room furnishings and perhaps even the personnel--are furnished free by the banks and are not counted against the 50 per cent subsidy which the banks have been authorized to make to the cafeterias."

In most of the cities in which the Reserve Banks or branches are located, it is well-established practice for business and industrial firms to provide low-cost meal service. In some areas, many of the large banks and insurance companies provide free meals to employees. This is a competitive factor in local labor markets where the Reserve Banks must recruit their employees. A first-class cafeteria serving low-cost, balanced meals is an internal economy factor as it minimizes absenteeism, increases productivity, and reduces turnover. The Reserve Banks' average cost of $67 per employee during the year 1957 for the subsidized food service is small in comparison to the advantages derived.

The Board has authorized the absorption by a Reserve Bank of up to one-half of the cost of operating its cafeteria, based upon the following expense items:

Salaries and retirement contributions of employees assigned to the cafeteria operation.

Cost of food, and cafeteria supplies (including ordinary day-to-day replacements of small utensils, dishes, glassware, etc.)

Cost of licenses, permits, and outside laundry and cleaning..

As Mr. Patman notes, the cost of operating Federal Reserve Bank cafeterias does not include allocations of overhead and space charges. Exclusion of these items from cafeteria and dining room costs is in line with commercial accounting practices.

Retirement System

On page 1585, Mr. Patman states: ". . . the Retirement System of the Federal Reserve is clear out of line with that of other Government employees. I believe in a good liberal retirement system, but I don't believe they should have a better system than the other Government employees because they work for the Government."

This statement with regard to the Federal Reserve Retirement System has been reviewed by the actuarial firm of George B. Buck. Mr. Buck is the Actuary of the Retirement System of the Federal Reserve Banks and is also Chairman of the Board of Actuaries of the Civil Service Retirement System. Mr. Buck's firm noted that--

1. Benefits to which employees of the Board of Governors are entitled under the Federal Reserve Retirement System are identical to those provided for Civil Service employees other than Members of Congress.

2. Under the Federal Reserve Retirement System, a Federal Reserve Bank employee is not eligible for full service retirement benefits until he has attained age 65 regardless of the number of years of his service; whereas, under the Civil Service System an employee may become eligible for full benefits at age 60 after 30 years of service or at age 62 after 5 years of service.

3. The cost to the employer of the total benefits (including Social Security) provided for Bank employees versus Civil Service employees is quite close to being the same.

The following figures compare the total service retirement benefits under the Bank Plan and Civil Service Plan for employees having a "final average salary" of $3,000 and $25,000 with 30 years of future service rendered after the effective date of the changes in the Bank Plan on September 1, 1957.

	Retirement benefits as a per cent of salary	
	Bank Plan (including Social Security)	Civil Service Plan
30 years service and "final average salary" of $3,000	55.8	58.3
30 years service and "final average salary" of $25,000	56.3	56.25

While some benefits of the Bank Plan, when compared with the Civil Service Plan, would be more favorable in certain cases and less favorable in others, the figures given above as well as those that apply at other salary levels show on the average closely comparable benefits between the plans. On the twenty-two salaries that exceed $25,000, the maximum retirement benefits

for 30 years' service would amount to 57.0 per cent of final average salary. In this latter group there are only two salaries that exceed $35,000--one at $50,000 and one at $60,000.

Deficiencies in Reserves

Mr. Patman stated (pages 1586-1587) that "there are all kinds of irregularities about the use of bank reserves," and that "they assess or waive penalties for deficiencies in member bank reserves on the basis of erroneous computations, or without authority."

All member banks are required to submit reports of deposits for reserve purposes--central reserve and reserve city banks on a weekly basis, and country banks on a semi-monthly basis. These reports, numbering over 162,000 a year, are compared at the Reserve Bank offices with the member banks' reserve accounts.

The Board delegates to the Reserve Banks discretion as to whether penalties are assessed or not in specified types of cases--for example, when the penalty is less than a certain amount, and when the deficiency is less than a stated percentage of required reserves and is offset by excess reserves during the immediately following reserve computation period. In all other cases, penalties incurred shall be assessed unless the Board, after a review of the facts of the case and the recommendation of the Federal Reserve Bank, authorizes the Reserve Bank not to make the assessment. Detailed instructions regarding these waivers were furnished to Mr. Patman, at his request, with the Board's letter of September 4, 1957.

From October 10, 1949 through August 15, 1957, during which about 1.3 million reports were reviewed for reserve purposes, only 76 cases were referred by the Reserve Banks to the Board, and in these cases the Banks were authorized not to make the assessment. Experience in this matter indicates that member banks conscientiously attempt to maintain adequate reserves, and

that deficiencies arise largely through inadvertence, clerical error, delay in mail, and absence of key employees of the member banks.

The Board believes there is no justification for the charge that there are all kinds of irregularities about the use of bank reserves.

Examination Procedures

In connection with the examinations of Federal Reserve Banks, which are conducted by the Board's examiners pursuant to the requirement of Section 21 of the Federal Reserve Act, Mr. Patman made the following comments (page 1588):

> "The Federal Reserve System, as I have pointed out, has never had a Government audit. It has never had any audit by independent auditors from outside the system itself. There are internal audits, made by personnel of the system, and even these audits--taking them for what they are, internal audits--show on their face to be subject to serious inadequacies and limitations. The audit teams are supposed to be made up so that the employees of one bank audit another bank, but even this principle is rarely followed 100 per cent. In practice the employees of a particular bank are on the team to help audit their own banks."

Since 1952 the Board has employed public accounting firms to audit its accounts. The certifications submitted in connection with these audits have been included in the Board's Annual Reports to Congress.

Beginning in 1953 the Board has also engaged the same public accountants to accompany the Board's examiners on one examination of a Reserve Bank each year for the purpose of obtaining an independent judgment as to the adequacy of the examination procedures and as to whether the procedures are being carried out properly. The reports submitted to the Board in this connection by the public accountants have consistently indicated the effectiveness of examinations made by the Board's examiners; for example, in a report dated June 13, 1957, the public accountants made the following statement:

"We believe that the examination conducted at the Federal Reserve Bank of San Francisco, including its four branches, conformed to the standards expected from an examination conducted by independent public accountants. The detailed audit procedures manuals set forth clearly an adequate examination procedure related specifically to the operations of the Banks. The audit assignments were carried out by the examiners in accordance with such audit procedures."

The Board's field staff of examiners comprises a group of approximately 35 examiners and assistant examiners who are employees of the Board. They work throughout the year under the active direction of the Chief Federal Reserve Examiner, who is an officer of the Board's Division of Examinations, responsible to the Director of that Division and through him to the Board of Governors.

Within each Federal Reserve Bank there is a General Auditor who has a staff which is engaged throughout the year in conducting internal audits of the affairs of the Bank and any branches of that Bank. The General Auditor and his staff are independent of the operating management and operating staff of the Bank and do not participate in operations. The General Auditor is responsible directly to the Board of Directors of the Bank, and he reports the results of the internal audits to the Directors.

During the first part of each examination of a Federal Reserve Bank conducted by the Board's field staff, there is necessity for verification of a very substantial volume of currency and securities which must be accomplished quickly in order not to interfere unduly with the Bank in the conduct of its day-to-day business. Moreover, in making simultaneous entry into all offices of a Bank which has several Branches, there is a temporary need for additional personnel to provide adequate coverage. It would be wasteful for the Board to maintain a field staff of examiners of sufficient size in itself to perform expeditiously all

the detailed work concerned with the opening phases of these examinations. Therefore, the Board's field staff utilizes the temporary assistance of men (a) from other Federal Reserve Banks--chiefly from the internal audit staffs of the other Banks; and (b) from the internal audit staff of the Bank under examination. The men borrowed temporarily from other Banks and from the Bank under examination are not conducting the examination; rather, they are assisting the Board's examiners and in so doing they are at all times under the active supervision of members of the Board's field examining staff. The temporary assistance received from within the Bank under examination is restricted entirely to members of the internal audit staff of the Bank who, as stated above, are independent of the operating personnel of the Bank.

Member-bank examinations

Mr. Patman cited on Pages 1603-1608 a number of factual reports by Board's examiners concerning the frequency of member-bank examinations made by the examining staffs of the Reserve Banks. He prefaced these citations by stating:

> "The Federal Reserve banks have set certain policies with respect to member-bank examinations. However, they make frequent exceptions to these policies throughout the Federal Reserve System.
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> "As an example, at the San Francisco Bank it was the policy to examine 4 of the 5 holding company affiliates within the district biennially, and the fifth, Transamerica Corp., on a triennial basis. However, the bank failed to make examinations of this holding company for 6 years. They make frequent exceptions to the policy of examining banks once a year and to their policy of making examinations jointly with State examiners.
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> "They do not always examine branches simultaneously with head offices, nor do they examine the commercial departments of banks concurrently with trust departments.

"On many occasions they defer examinations when mergers are pending, when banks are making alterations on the premises, and when examining personnel is not available, and fail to examine new banks."

State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners from the Federal Reserve Bank of the district in which the member bank is situated, with additional examinations if considered desirable.

In carrying out this policy, the Board has not required that all examinations of trust departments or all examinations of branches of State member banks be made simultaneously or concurrently with examinations of their head offices, nor has the Board required that all examinations of the commercial or trust departments of State member banks be made jointly with State examiners.

The programs for examination of State member banks have been substantially completed in all recent years. Deviations from the general policy have been largely due to a shortage of qualified examiners, and almost without exception have involved State member banks in sound condition and under capable management. A large majority of the banks not examined in a specific calendar year were examined during the latter part of the previous year and, as a general rule, during the early months of the following year. In no case was there a deferment involving a bank considered to be in unsatisfactory condition. During the period 1952-1956, all newly organized banks were examined within one year by either the

State banking department or the Federal Reserve Bank, and in a majority of cases by both authorities.

The approach to the examination of branches of State member banks is governed almost without exception by the aggregate number, size and location of the branches of the institution under examination. At banks with a small or medium number of branches, it is customary to examine all offices simultaneously with the head office, but it is not possible to follow this policy consistently when a large number of branches is involved. However, in every case, statements of all branches are obtained as of the date of examination of the head office and are reconciled to the books of the head office as of that date.

Due to the specialized character of fiduciary activities and the required separation from commercial banking activities of fiduciary responsibilities and related functions, records and assets, it is the judgment of supervisory authorities that the examination of the commercial and trust departments of State member banks other than on a simultaneous basis does not represent a departure from sound examination principles.

The examination of Transamerica Corporation which would ordinarily have been made on a triennial basis in 1949 was omitted because of the Clayton Act proceedings with respect to the Corporation which were in process at that time. The Board's order in these proceedings was issued March 27, 1952 and an examination of the Corporation was commenced on April 21, 1952.

Verification and Destruction of Currency

With regard to the work which the Federal Reserve Banks are performing in connection with the verification and destruction of unfit

Treasury currency, Mr. Patman suggested (page 1591) that it is a disgrace for Congress to permit "people to have complete control of United States currency who do not consider themselves obligated to the Government. . ." His statement continued:

> "They have charge of destroying the worn and mutilated currency. And, of all the irregularities and seemingly dishonest dealings in connection with it, you will find plenty of eye openers in these reports that even their own auditors made about the irregularities in handling the tremendous amount of money that is destroyed every year, and the loose fashion in which it is handled.
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> "Up at Pittsburgh, a cyclone or a heavy wind hit the City while currency was being destroyed in the Municipal incinerator and scattered money all over Pittsburgh, Pa. The only reason we found out about it through the newspapers and they had to redeem a lot of that currency because it wasn't burned and under certain conditions it is redeemable."

Mr. Patman's statement then quoted certain criticisms and other comments concerning individual Reserve Banks, as shown in the reports of examinations made by the Board's examiners.

Under date of June 24, 1953, the Secretary of the Treasury directed the Federal Reserve Banks and branches as fiscal agents of the United States, under the provisions of Section 15 of the Federal Reserve Act, to verify and destroy unfit United States paper currency. The proposed change in procedure was discussed by Treasury representatives with appropriate Congressional committees during the hearings on the Treasury appropriation for the fiscal year 1954. In this connection Secretary Humphrey's letter of May 22, 1953 to Chairman Canfield of the Treasury-Post Office Subcommittee of the House Committee on Appropriations concluded: "Since the net savings resulting from this change of procedure will be substantial, it is assumed that your Committee would concur in the

Department's proposal to proceed along the lines indicated."

From the time the Reserve Banks began this work on July 1, 1953, it has been performed under regulations issued by the Treasury Department. A copy of these regulations was forwarded to the House Banking and Currency Committee with the Board's letter of December 16, 1957. As stated on page 1801, the Treasury Department has advised the Board that it is their practice to visit the Reserve Banks which destroy currency at least once a year for the purpose of observing the verification and destruction operations. One purpose of these visits is to ascertain that the operation is being conducted in a manner satisfactory to the Treasury.

Certain safeguards and other controls covering this operation are described on pages 1742-1750 and 1780-1792. In many respects the safeguards in effect at the Reserve Banks go beyond Treasury regulations. In some cases the additional safeguards were the result of suggestions by the Board's examiners, such as shown on pages 1592-1595 of Mr. Patman's statement. However, in considering the matter of suggested additional precautions over and above the requirements of the Treasury regulations, the Reserve Banks must balance the added protection against its cost, and in this light some of the examiners' suggestions were not deemed feasible.

The Pittsburgh incident mentioned by Mr. Patman on page 1591 occurred when an unknown quantity of cancelled currency escaped incineration because of completely unforeseeable malfunctioning of the incineration facility of the City of Pittsburgh. The City incinerator was used in July of 1953 to destroy the first batch of currency at the Pittsburgh Branch because at that time the Branch had no facility of its own. This incinerator was then also used by local offices of the United States District Court, the

Federal Bureau of Investigation, the Internal Revenue and other departments of the Federal Government to destroy confidential records. Before its use for the destruction of currency, the facility was thoroughly tested, and its use was approved by the Treasury Department. Nevertheless, before the cancelled currency was completely destroyed an unknown amount passed through the grates into the water tanks provided for receiving the ashes. A complete account of this incident appears on pages 1794-1799.

When it occurred, the matter was reported immediately to the Secret Service, the Federal Bureau of Investigation, the Pittsburgh Police Department, the Treasury Department, and the Board. Contrary to the statement on page 1591 that "they had to redeem a lot of that currency," all of the money was cancelled and valueless before it was taken to the incinerator. There has been no loss to the Treasury as a result of this incident or of any of the others which have occurred (described on pages 1793-1794 and 1799-1800.) All of the cancelled money which has been presented to the Federal Reserve Banks for redemption has been confiscated, and in all but a very few cases the Reserve Banks have refused to give credit or value for it.

The exceptions to this last statement constitute three $5 bills and five $1 bills which were accepted at face value and charged to profit and loss by the Reserve Banks because of operating circumstances, such as the fact that the notes were partially burned and discovered to have been cancelled too late in the sorting process at the Reserve Bank to permit identifying the bank which deposited them. From the time the Reserve Banks undertook the currency destruction work on July 1, 1953 to the present time, their loss as a result of this operation has totaled $20.

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