

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, August 13, 1947.

PRESENT: Mr. Szymczak, Chairman pro tem  
Mr. Draper  
Mr. Evans  
Mr. Clayton

Mr. Sherman, Assistant Secretary  
Mr. Morrill, Special Adviser  
Mr. Thurston, Assistant to the Chairman

Minutes of actions taken by the Board of Governors of the Federal Reserve System on August 12, 1947, were approved unanimously.

Memorandum dated August 6, 1947, from Mr. Young, Assistant Director of the Division of Research and Statistics, recommending the transfer of William E. Hardy, a laborer in the Division of Administrative Services, to the Division of Research and Statistics as a messenger, with an increase in basic salary from \$1,690 to \$1,822 per annum, both effective as of the date upon which he enters upon the performance of his duties in the Division of Research and Statistics. The memorandum also stated that Mr. Bethea was agreeable to the transfer.

Approved unanimously.

Letter to Mr. Volberg, Vice President of the Federal Reserve Bank of San Francisco, reading as follows:

"This refers to your letter of March 29, 1947, and the subsequent conversation of our Division of Examinations with Mr. Earhart, regarding the annual report to shareholders for the year ended December 31, 1946,

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"of First Security Corporation of Ogden, Ogden, Utah."

"Your letter calls attention to the fact that the balance sheet contained in the report to shareholders differs substantially from that included in the Corporation's report to the Board for the year ended December 31, 1946, in that the carrying value of the investment in subsidiaries has been adjusted to reflect the holding company's interest in the capital, surplus, undivided profits, and reserves for contingencies of the subsidiary banks and operating companies as shown by their respective balance sheets. For your information with respect to this method of carrying investments in subsidiaries, there are several bank holding companies which have for some time carried such investments in their assets at the amount of the holding company's interest in the capital, surplus, and undivided profits shown by the balance sheets of the subsidiaries. You will find illustrations of this practice in the information contained in 'Moody's Manual of Investments' regarding Wisconsin Bankshares Corporation, Milwaukee, Wisconsin; Marine Midland Corporation, Jersey City, New Jersey; Northwest Bancorporation, Minneapolis, Minnesota; and Shawmut Association, Boston, Massachusetts. For convenient reference with respect to this matter, we are sending you a copy of the Northwest Bancorporation's report to shareholders for the year 1946.

"It is noted that the current transfers to the reserves for contingencies of the holding company and its subsidiaries are handled in such manner as to reduce the net income for the current year in the holding company's statement of earned surplus on page 15 and the condensed analysis of consolidated income on page 14. However, the total net worth shown in the holding company's balance sheet on page 13 includes the reserve for contingencies of the holding company and its proportionate interest in the reserves for contingencies of its subsidiaries. Thus the reserves for contingencies are set apart from net worth in the income statements but are included in net worth in the balance sheet. It seems to us that this is inconsistent.

"We have noted the paragraph on page 5 of the report to shareholders regarding certain sales and purchases of securities by the banks in the group, which reads in part as follows:

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'In these transactions, instead of placing the profit realized from the sale to Reserve for Contingencies, we transferred the profit to Deferred Credits to Income, and will amortize it into our earnings over the life of the new bonds purchased.'

"It is observed, however, that the holding company's interest in the amounts referred to as deferred credits to income is included, on page 12 of the report, in the carrying value of the investment in subsidiaries as a part of the amount shown opposite the caption 'Increase to Include Contingency Reserves as shown by Statements of the Banks'. Also, the holding company's interest in the deferred credits to income is shown as a part of its total net worth on page 13. It is, therefore, not clear to us that the securities profits referred to in the sentence quoted above have in fact been treated in the balance sheet of the holding company as deferred credits to income to be amortized into future earnings.

"Your letter pointed out that the individual income and expenses of the Corporation are reflected only in gross total in the statement of earned surplus, and there is no statement of the reserve for contingencies although the reserve was increased \$150,000 during the year. In the annual report to shareholders for 1945, more detailed information was furnished regarding the earnings of the holding company as a separate entity. The more detailed presentation, informing the shareholders more fully regarding the year's operations, is preferred over the condensed form appearing in the 1946 report. If the detailed form had been continued in use, the transfer of \$150,000 to the Corporation's reserve for contingencies would have been shown as a separate item, instead of being combined with unrelated items totaling \$88,536.71 opposite the caption 'Appropriations from Income and Expenses'.

"We agree with your opinion that the caption of the graph on page 5 of the report is inaccurate, and that it should have been so designed as to indicate clearly that the earnings reflected in the graph are the consolidated earnings of the Corporation and its operating subsidiaries, whereas the dividends reflected are those of the Corporation only.

"In the condensed statements of condition of the banks on pages 16 and 17, the combined total of deposits of the

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"banks is shown without indicating the amount of deposits of affiliated organizations included therein. This figure appears also in the text of the report on page 6. In the report to shareholders for the year 1945, the amount of the intra-group deposits was shown in a footnote under the statements of the banks, and was eliminated from the amount used in the text. In the interest of avoiding publication of deposit totals of a bank group in such manner as to overstate its transactions with interests not included in the group, we regard the practice followed in the 1945 report as being preferable to that followed in the 1946 report."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks and members of the Federal Advisory Council reading as follows:

"During the past few years, the Board has given a great deal of consideration to the basis for designation of reserve cities. It will be recalled that, at the request of the Board, surveys were made on two separate occasions as to the advisability of terminating the reserve city status of reserve cities other than those in which Federal Reserve Banks and branches are located. These surveys indicated that a majority of the member banks in such cities, particularly the larger ones, were opposed to the suggested termination.

"The Board, however, has continued to recognize the need of establishing some logical and fair basis for designation of reserve cities. Following discussions in May 1946 between the Board and the Federal Advisory Council and in June 1946 at the joint meeting of the Board and the Presidents' Conference, the subject of reserve city designations and reserve requirements was reviewed by a special subcommittee of the System Research Advisory Committee and the Subcommittee of the Presidents' Conference Committee on Research and Statistics. The special subcommittee submitted an 'Interim Report on Member Bank Reserve Requirements', copies of which were distributed to the Board and the Presidents' Conference in February 1947. After consideration of the interim report and of a number of proposals developed pursuant to discussions of the subject

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"by the Board, a plan, outlined in the accompanying enclosure, has been selected by the Board to become effective January 1, 1948. Before the plan is actually put into effect it will, of course, have to be published in the Federal Register as required by the Administrative Procedure Act. The meetings of the Federal Advisory Council in September and the Presidents' Conference in October will afford opportunities for discussion of the plan before such publication, and this letter is, accordingly, being sent to the Presidents of the Federal Reserve Banks and the members of the Federal Advisory Council.

"The plan provides that, effective January 1, 1948, Federal Reserve Bank and branch cities, Washington, D. C., and all other cities in which member banks held  $1/4$  of 1 per cent or more of total interbank deposits held by all member banks in the United States will be designated as reserve cities, and the designation of existing reserve cities in which member banks held less than  $1/4$  of 1 per cent of such deposits will be terminated. The Board expects to make another review of reserve city designations at the end of a five-year period but, if in individual cases circumstances warrant, the Board may make changes in such designations within a shorter period of time.

"The policy that all cities in which Federal Reserve branches are located, as well as cities in which Federal Reserve Banks are located, should be reserve cities was adopted by the Board in 1918, largely on the grounds that banks in such cities need carry less vault cash than banks located outside such cities; that branch cities in general are financial or business centers and therefore deposits of other banks are attracted to such centers; and that banks in such cities, because of their accessibility to the Federal Reserve branches, are in a better position to avail themselves of certain other facilities of the Federal Reserve System.

"The standard selected for designating other reserve cities, the volume of interbank deposits, appears to be the most logical basis within the framework of existing law. As a practical matter, the balance carried by a member bank on deposit with another member bank is part of its total 'effective' reserves, the same as vault cash and its legal reserve with the Federal Reserve Bank; it

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"is readily convertible into legal reserve with its Federal Reserve Bank.

"The determination of what constitutes a substantial volume of interbank deposits, justifying the higher reserve requirements which the law prescribes for reserve city banks, is necessarily a matter of judgment. The basis used for determining whether a given city should be designated as a reserve city-- $1/4$  of 1 per cent of total interbank deposits of all member banks in the United States--results in designating every city in which the interbank deposits of member banks total approximately 30 million dollars or more. It also results in terminating the reserve city status of every present reserve city in which the interbank deposits of member banks are less than about 30 million dollars.

"For your information and convenience, there are enclosed tables showing total deposits and interbank deposits on December 31, 1946 of member banks in each city considered under the proposed plan, and the ratio of such interbank deposits to total interbank deposits of all member banks in the United States on each call date in 1945 and 1946.

"The Board recognizes that statutory changes may be needed to provide a fully satisfactory basis for differentials, if any, in reserve requirements. Accordingly, it has directed the System Research Advisory Committee to study the question of possible changes to be made in the law with respect to the classification of deposits for reserve purposes. The Board believes, however, that, regardless of whether it decides eventually to request statutory changes in existing reserve requirements, there should be no further delay in putting into effect a definite plan for designation of reserve cities within the framework of existing law."

Approved unanimously.

Letter to Mr. Knoke, Vice President of the Federal Reserve Bank of New York, reading as follows:

"The attention of the Board is being called to your letter of August 7, 1947, describing the progress which you have made in informing your foreign correspondents

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"that their operations in official foreign funds should conform to our domestic monetary policy. It would be appreciated if you would continue to keep the Board informed of developments in this field."

Approved unanimously.

*Wm. H. Sherman*  
Assistant Secretary.

Approved:

*W. J. [Signature]*  
Chairman pro tem.