Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, May 2, 1951.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Evans
Mr. Norton
Mr. Powell

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary

Minutes of actions taken by the Board of Governors of the Federal Reserve System on May 1, 1951, were approved unanimously.

Memorandum dated April 30, 1951, from Mr. Carpenter, Secretary of the Board, recommending that the resignation of Mrs. Hazel L. Larson, a file clerk in the Office of the Secretary, be accepted to be effective, in accordance with her request, at the close of business May 3, 1951.

Approved unanimously.

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

"As requested in your letter of April 23, 1951, the Board of Governors approves the payment of salary to Mr. Otto W. TenEyck, Assistant Vice President, at the rate of $13,000 per annum for the period May 1, 1951, through December 31, 1951."

Approved unanimously.

Letter to the Honorable Estes Kefauver, United States Senate, Washington, D. C., reading as follows:

"This refers to a letter addressed to you by Mr. Paul Y. Richardson of the Southern Electric Appliance Company in Tennessee, and forwarded to Chairman Martin. The letter relates to the effect of Regulation W on television and appliance sales.

"The Board has been in close contact with representatives of television manufacturer and dealer groups, and has been giving serious consideration to the current problems in the television market. While we are studying the effect of the regulation on the market situation, there are many factors other than credit restrictions which are affecting the market at this time. The near saturation of the present market, the possibility of color television, and the imminence of ultra-high frequency transmission are significant market factors, among others.

"The Board is very much interested that the provisions of Regulation W may not be unduly restrictive in the case of individual products, but it must also consider that the regulation must strongly curb instalment credit as a whole if it is to accomplish its purpose of helping to restrain the serious inflationary forces in the present emergency period. We are certain you understand the necessity for avoiding the widespread hardship which would prevail if current inflationary tendencies in the economy as a whole were allowed to continue unabated.

"We are returning Mr. Richardson's letter as you requested."

Approved unanimously.

Letter to the Honorable Raymond M. Foley, Administrator, Housing and Home Finance Agency, 1626 K Street, N. W., Washington, D. C., reading as follows:

"At a meeting on March 29, 1951, the Board of Governors approved the issuance of a registration statement under the provisions of Regulation X. A copy of this statement is enclosed and additional copies have been sent to Messrs. Ratcliff, Morton, and Lowery of your staff.

"It will be necessary to amend Regulation X with respect to the issuance of the registration statement for the purpose of assuring that Registrants have received constructive notice of the statement through the Federal Register. Copies of the proposed amendment, which the Board is prepared to approve, and the public announcement of registration under Regulation X are enclosed. As soon as the effective date of the amendment has been decided, you will be notified.

"The registration statement has been sent to the Bureau of the Budget for final clearance after which it will be released through the Federal Reserve Banks and Branches. It is contemplated that Registrants will be required to prepare the information needed for the registration statement as of May 31, 1951, the form to be returned to the Reserve Banks not later than June 30, 1951.

"It will be appreciated if you will advise whether you concur in the enclosed registration statement and amendment No. 5 to Regulation X, described as footnote 11a to subsection (b) of section 3, and the effective date of such concurrence."

Approved unanimously.

Letter to Mr. Gaylord A. Freeman, Jr., Vice President, The First National Bank of Chicago, Chicago, Illinois, reading as follows:

"A copy of your letter of March 20, 1951, to President Young of the Federal Reserve Bank of Chicago was referred to the Board of Governors because your inquiry refers to System practice and the Reserve Bank felt that you would like to have an expression from the Board.

"It is noted that you do not consider it possible to devise a single formula to determine the adequacy of a bank's capital but feel that certain tests may serve to distinguish between those banks which clearly have adequate capital and those the adequacy of whose capital may require further analysis. Your inquiry relates to the tests used throughout the System in this process of screening.

"The Board recognizes that it would be convenient and administratively desirable to have a 'yardstick' which could be applied to every situation but concurs in your "opinion that no such formula is practicable. Therefore, there are no instructions currently outstanding which have been issued by the Board of Governors to all Reserve Banks and which are to be applied uniformly in appraising capital adequacy.

"The aggregate capital of banks is significant for certain purposes relating to the banking structure and the banking system but, from the standpoint of bank supervision, the important consideration is the adequacy of capital in individual banks. For many years the Board has prescribed a standard condition of membership for State banks desiring admission to the System which provides:

> '2. The net capital and surplus funds of such bank shall be adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, and its capital shall not be reduced except with the permission of the Board of Governors of the Federal Reserve System.'

"The two ratios used by the Reserve Banks and the Board's Division of Examinations in the process of preliminary screening are the ratio of capital to total assets and the ratio of capital to so-called risk assets, defined as total assets less cash, bank balances and Government securities. Nevertheless, such ratios are recognized as being very rough bench-marks even for screening purposes and it is hardly probable that a review analyst, in appraising the ratios found, would not be aware of other factors affecting the institution under review which would indicate the need or lack of need for further analysis. However, in present circumstances, if the ratio of capital to total assets equals the national average of approximately 7 per cent and the ratio of capital to risk assets is around 25 per cent (about eight percentage points higher than the national average) and no other and unusual factors and trends are apparent, it is felt that the question of capital adequacy need not be pursued further.

"The further analysis, if desired after screening, may be as extensive and may involve as many factors as the particular case may require. While it is apparent that you are familiar with the factors that may appropriately be considered in determining the adequacy of the capital of a given bank, it may be said that such consideration should include the character and condition of its assets, the "demonstrated ability of its management, and the nature of its deposit and other liabilities. In reaching a supervisory conclusion as to the necessity for injecting additional new capital, such factors as earnings, dividend policies, etc., would be considered.

"Reference is made above to demonstrated ability of management. It is true, of course, that management is one of the primary considerations in appraisal of the probable future of a bank, including actual capital needs. Even with the best of management, however, certain minimum capital requirements are necessary from the supervisory standpoint because management is always subject to change. Because of the importance of management in supervisory analysis, it may be worth while to note a few, but by no means all, of the items indicative of managerial capacity in the process of analysis. These would include quality of the loan and securities portfolios; the ratio of actual risk assets to total assets; source and sufficiency of earnings; policies with respect to service charges, dividends and retention of earnings; the borrowing record; charge-off policy and record of recoveries; policy with respect to reserves; provision and maintenance of proper accounting, control, and audit procedures; etc.

"It is realized that the foregoing is not as definite as you may desire but it would appear to coincide with your own idea of the problem and, to that extent at least, it is hoped that it may be helpful. The matter of capital adequacy is of great and continuing interest and, when your statement for the Illinois Bankers Association is prepared, the Board would be very glad to receive a copy."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks, reading as follows:

"The Board of Governors is in accord with the following action taken at the meeting of the Conference of Presidents held March 7-8, 1951, as indicated in the minutes of that meeting.

'It was suggested that the Conference reaffirm as a general policy for the Banks the recommendation approved at the Conference meeting of June

"'7, 1946, to the effect that Federal Reserve Banks should not receive from member banks for safekeeping securities in which third parties have an interest except (1) securities pledged as collateral by member banks to secure deposits of public funds, and (2) securities deposited with a public official to qualify member banks to exercise trust powers, but with the understanding that this policy be interpreted to provide recognition of the fact that there may be exceptional cases in addition to those specifically mentioned which should be handled at the discretion of the individual Reserve Bank. On motion, the Conference unanimously agreed to adopt this suggestion as a statement of policy.'"

Approved unanimously.

Secretary.