

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, August 11, 1952. The Board met in executive session in the Board Room at 10:00 a.m.

PRESENT: Mr. Szymczak, Chairman pro tem.
Mr. Evans
Mr. Vardaman
Mr. Mills
Mr. Robertson

At the conclusion of the executive session Mr. Carpenter, Secretary, was called into the meeting.

There was presented a draft of a reply telegram to President Earhart, of the Federal Reserve Bank of San Francisco, reading as follows:

"Referring your wire August 7 re McGuire dissertation. Board believes information made available to McGuire should rest in your discretion having in mind that no unpublished information of the Board as defined in section 8 of the Board's Rules of Organization which would disclose important policies or other confidential information should be given McGuire."

Mr. Earhart's telegram of August 7 and the proposed reply grew out of a request from Joseph W. McGuire, of the faculty of the University of Washington, who was writing a doctoral dissertation, "The Federal Reserve Bank of San Francisco and the Twelfth Federal Reserve District, 1930-1952", and had asked for an opportunity to study for a two-weeks' period at the Federal Reserve Bank of San Francisco where he could look over certain records of the Bank. Mr. Earhart's wire stated that, while it was assumed there would be no objection to giving Mr. McGuire access, in the Bank's discretion, to unpublished material in the Bank's files, the Board's permission was being requested in accordance with section 8 of the Board's

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Rules of Organization.

The proposed reply had been circulated among the members of the Board for approval and Governor Vardaman had indicated that he did not wish to approve. At this meeting Governor Vardaman expressed the view that the proposed telegram would set an undesirable precedent as being some indication that the Board was sanctioning the study and that in his opinion, since other Federal Reserve Banks were handling matters of this kind informally without bringing them to the attention of the Board, this case should be handled in the same way.

There was a discussion of what action the Board might take in connection with the matter, including a possible discussion at a meeting of the Presidents' Conference, and whether it might be desirable to indicate to the Reserve Banks that the Board would encourage study of the Federal Reserve System and its operations by responsible students as long as confidential information was not disclosed.

At the conclusion of the discussion the proposed reply was approved, Governor Vardaman voting "no".

Brief reference was made to a memorandum addressed to the Board by Mr. Leonard, Director of the Division of Bank Operations, under date of August 8, 1952, with respect to a program to facilitate the continued transaction or the resumption of commercial banking operations in the event of an enemy attack upon this country. Copies of the memorandum

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and attachments had been furnished to each member of the Board before this meeting.

Governor Robertson stated that he would like to have the memorandum brought up for consideration at a meeting when all of the members of the Board were present, at which time the proposed program could be discussed in detail.

The following additional actions were taken by the Board:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on August 8, 1952, were approved unanimously.

Memorandum dated July 21, 1952, from Mr. Young, Director, Division of Research and Statistics, recommending an increase in the basic salary of Homer Jones, Chief, Consumer Credit and Finances Section in that Division, from \$11,550 to \$11,800 per annum, effective August 17, 1952.

Approved unanimously.

Letter to Mr. Earhart, Chairman of the Presidents' Conference Committee on Miscellaneous Operations, Federal Reserve Bank of San Francisco, reading as follows:

"In response to your letter of June 24, 1952, and to complete the record Mr. Myrick, Assistant Director of the Division of Bank Operations, will continue to serve as an associate of the Subcommittee on Cash, Leased Wire, and Sundry Operations, the Subcommittee on Destruction of Records, and the Subcommittee on Electronics, and Mr. Bethea, Director of the Division of Administrative Services, will

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"serve as an associate of the first named subcommittee in matters pertaining to the Federal Reserve Leased Wire System."

Approved unanimously.

Letter to Mr. Neal, First Vice President, Federal Reserve Bank of Boston, reading as follows:

"This will acknowledge your telegram of July 29 advising that you have under consideration a request from the Governor of the Bank of Greece that Mr. Michael Stamos, a member of the Bank's staff, be permitted to study the operations of your institution for several months beginning in September.

"Compliance with this request would appear to be in line with our general policy of assisting accredited representatives of other central banks in improving their knowledge of the Federal Reserve System, and we would have no objection to your making the necessary arrangements with the Bank of Greece. The matter has been discussed informally with a representative of the State Department and, while no information was immediately available regarding this particular request or Mr. Stamos personally, it was felt that assistance to him would be in conformance with the general objectives of State Department policy.

"As you probably are aware, the System has arranged to provide the Bank of Greece with technical advice on two occasions recently. In 1950 Mr. Johns, who was then Vice President of the Federal Reserve Bank of Kansas City, spent several months in Greece in connection with the revision of banking legislation, and later Mr. Dillistin, formerly General Auditor of the Federal Reserve Bank of New York, undertook an assignment to Greece in connection with the establishment of a system of bank examinations.

"Should you decide to accept the proposal of the Bank of Greece and allow Mr. Stamos to study at the Reserve Bank, we would be interested in having for the completion of our records further advice from you as to the nature of his program. For the same reason we would be interested in learning whether it was possible to provide assistance to Kee Il Choi, a Korean student whose petition submitted

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"through the Korean Ambassador was the subject of my letter to President Erickson of May 15, 1952."

Approved unanimously.

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

"This letter supersedes the Board's letter of March 18, 1943 (S-623, F.R.L.S. #3593) with reference to the uniform system for rating member banks and relates to other procedures in the process of supervision of member banks as discussed with the Conference of Presidents on June 19, 1952.

"While any Federal Reserve Bank may continue to use for its own purposes any method of rating banks it may consider desirable, it is requested that, for the purposes of the Board of Governors, all member banks be rated in accordance with the following formula which is essentially that used by the Comptroller of the Currency for rating national banks, the largest portion of member banks:

Composite or Group Rating

Rating No. 1

Banks rated No. 1 should be sound institutions in every respect.

Rating No. 2

Banks rated No. 2 are those with (a) asset weaknesses ranging from relatively moderate to moderately severe, or (b) negligible asset problems but definitely undercapitalized, or (c) unsatisfactory managements, or (d) a modified combination of these and other weaknesses.

Rating No. 3

Banks should be rated No. 3 which have, in relation to capital protection, an immoderate volume of asset weaknesses which, in view of the (a) character of the asset problems, or (b) management deficiencies, or (c) economic conditions, or a combination of these and other points, could reasonably develop into a situation urgently requiring aid either from the shareholders or otherwise. Banks in this category require special attention.

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"Rating No. 4

Banks rated No. 4 are those confronted with asset weaknesses of a character and volume, in relation to capital protection and quality of management, urgently requiring aid from the shareholders or otherwise and whose failure, if such aid is not forthcoming, would appear to be probable. These are the serious or hazardous cases requiring constant supervisory attention.

Capital PositionRating No. 1 or Roman Numeral I

Capitalization adequate in relation to

- (a) volume of risk assets, and
- (b) volume of marginal and inferior quality assets, and
- (c) volume of deposits.
- (d) Points a, b, and c to be considered in relation to strength of management.

Capitalization will not be considered adequate unless in the judgment of the Vice President in Charge of Examinations it is adequate in relation to the above enumerated points. Consideration will, of course, be given to earnings retention capacity. Ratios are not the primary determinant of this rating. Judgment must be exercised in deciding whether capital-wise a bank comes within this category. Although some banks will be regarded as undercapitalized with better ratios, in general banks will be considered undercapitalized if their secondary risk asset ratios are (a) worse than \$1. to \$6., or (b) if their ratios of capital to deposits exceed \$1. to \$25. However, in any case where a bank has a higher ratio than \$1. to \$6. or \$1. to \$25., but the institution is nevertheless believed to be adequately capitalized and deserving of a number 1 rating, this judgment will be so indicated by using Roman Numeral I.

Rating No. 2

Capitalization inadequate in relation to

- (a) volume of risk assets, or
- (b) volume of marginal and inferior quality assets, or
- (c) volume of deposits.
- (d) Points a, b and c to be considered in relation to strength of management.

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"While adequate capitalization is based on adequacy in relation to points a, b and c, as a group, and the weighing of those three points in relation to management competency, capital inadequacy may exist because of the adverse relationship of the capital structure to any one of the first three points (a, b or c), giving due weight to management as a possible mitigating factor, but not beyond a reasonable point. The least important factor is the relationship of capital to deposits unless extreme. The Federal Reserve Bank officials must exercise their own best judgment with reasonable emphasis on conservatism in determining capital adequacy or inadequacy for rating purposes. The exercise of judgment is required by the use of Roman Numeral I for those banks considered adequately capitalized despite ratios that normally would be regarded as sufficiently adverse to warrant a 2 or inadequate capitalization rating.

Rating No. 3

Inadequate capitalization is worse than defined under No. 2 above and is regarded as hazardous. This normally will include all banks whose aggregate of classified assets is sufficient to impair the capital account.

Rating No. 4

Capital impaired by losses.

Quality of Assets

Rating A

Good. Ordinarily banks so classified will not have an aggregate total of (1) classified assets, plus (2) 50% of other loans Especially Mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, that is in excess of 20% of the gross capital structure, and the character of the problems in such assets is not severe in the judgment of the Federal Reserve Bank officer making the rating. An aggregate total of such assets somewhat in excess of 20% of the gross capital structure will not preclude an A rating, provided the actual or potential seriousness of the problems in the assets concerned is regarded as relatively moderate. However, if the primary asset problems are regarded as severe, or if additional problems exist in Large Lines, bond concentrations, or a heavy investment in fixed assets, a less favorable rating should be used even though the aggregate total of primary asset problems is less than 20% of the gross capital structure.

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"Rating B

Fair. Instructions, and elasticity to exercise judgment through use of a more favorable or less favorable rating, are the same as noted under rating "A" except banks so classified ordinarily will not have an aggregate total of (1) classified assets, plus (2) 50% of Other Loans Especially Mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, that is in excess of 40% of the gross capital structure.

Rating C

Unsatisfactory. Instructions, and elasticity to exercise judgment through use of a more favorable or less favorable rating, are the same as noted under rating "A", except banks so classified will not have an aggregate total of (1) classified assets, plus (2) 50% of Other Loans Especially Mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, that is in excess of 80% of the gross capital structure.

Rating D

Hazardous. Any bank will be so classified when the total of (1) classified assets, plus (2) 50% of Other Loans Especially Mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, is in excess of 80% of the gross capital structure.

Management Rating

S	Strong or Competent
F	Fair
P	Poor, Incompetent, Integrity Questioned

It is desired that the Capital, Asset, and Management ratings be entered at the bottom of Page E of the copy of each report of examination by Vice Presidents in Charge of Examinations (initials opposite ratings), as follows:

I - C - F (initials)

"In order to provide information for use in determining the rating in accordance with the formula it is requested that the total of Loans subject to Special Mention be shown on page 11(c) of the report of examination. Also, an additional sheet designated as 'D-2' has been prepared for use in the Confidential Section of the report, and to be included prior to page 'E', which will show the estimated value of non-ledger assets and the

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"amount of the various types of assets to be considered in the secondary computation of the risk asset ratio. A supply of these forms has been forwarded to the Vice President in Charge of Examinations at each Federal Reserve Bank and additional supplies will be available upon request.

"Since the total of Loans subject to Special Mention is involved in the determination of the quality of assets rating, the definition of loans of this character now appearing on page 11(c) of the form for report of examination of a State member bank by a Reserve Bank is changed to read:

'This schedule includes loans or portions thereof which are superior in quality to those classified Substandard, but which, for the reasons indicated are believed to warrant more than usual management attention.'

This definition will appear at the head of the schedule on page 11(c) when an additional supply of this page is printed.

"It is felt that the Board's Division of Examinations should receive and the Board's files should contain full information with respect to supervisory action taken in the case of State member banks. It is requested, therefore, that in addition to the information furnished on Form F.R. 212, copies of all communications between the Reserve Banks and State member banks, with respect to such matters be forwarded to the Board. It is not contemplated that copies of all correspondence including routine letters of transmittal, etc. between the Reserve Banks and member banks be forwarded to the Board, but copies of all correspondence pertaining to requests for corrective action of any character should be forwarded.

"It is requested also that an analysis of reports of examination of national banks and reports of examination of State member banks made independently by State authorities and received by the Reserve Bank be forwarded to the Board. The analysis of such reports of examination should be made on Form F.R. 209, a supply of which has been forwarded to the Vice Presidents in Charge of Examinations and additional supplies will be available upon request.

"It is requested also that the trust departments of all member banks be rated on a basis of individual judgment. Rating selection would be the product of the experience and judgment of the Review Examiner or Chief Examiner supported by the facts and opinions contained in the trust examination report. While emphasis,

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"for this purpose, would be upon the effect, immediate and future, of the trust function on the condition of the bank, consideration also would be given to the following factors:

- (1) The character and competency of trust department management.
- (2) The general quality of the administration provided.
- (3) Whether or not trust operations are a source of profit to the bank.
- (4) The extent and seriousness of problems or unsatisfactory features (including any probable liability attaching thereto).

"In the case of every member bank exercising trust authority, the trust function should be rated on the basis of the considerations outlined above, in one of the three following categories:

- | | |
|---|----------------|
| A | (Satisfactory) |
| B | (Fair) |
| C | (Poor)" |

Approved unanimously.

Letter to Mr. R. J. Saulnier, National Bureau of Economic Research, Inc., W. 254th Street and Independence Ave., New York, New York, reading as follows:

"This refers to your letter of July 28 in which you request that the Board, with the cooperation of the offices of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, make available to you certain items from condition reports of State member banks, national banks, and insured nonmember commercial banks. It is understood that you have also written to the Comptroller of the Currency and the Federal Deposit Insurance Corporation, requesting their clearance so far as the requested data pertain to national banks and insured nonmember commercial banks, respectively.

"As noted in your letter, the Board has already expressed its interest in the study of bank capital problems which you have under way, and its willingness to cooperate with you in the study. Accordingly, the Board will be glad to make the requested data available to you as soon as clearance is given

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"by the Comptroller's Office and the Federal Deposit Insurance Corporation. The data to be furnished you are as follows:

1. Punched machine cards showing as of December 31, 1951, for each insured commercial bank the ten balance sheet items and the seven items from the loan schedule listed in the enclosure with your letter. The balance sheet items appear on the face of condition reports, are required to be published by member banks, and probably are published by all nonmember banks. The items from the loan schedule, however, are not required to be published by member banks and, accordingly, in order to avoid identification of these items for individual banks, the punched code numbers for each bank and each State will be 'scrambled', and the code for class of bank will be omitted. The same 'scrambled' code will be used, however, on every card of each bank, including the cards containing the balance sheet items, so that the cards for a given bank can be properly matched. The code numbers representing the Federal Reserve district and the population group will not be 'scrambled', since it is understood that you wish to make analyses by regions and by size of cities.

"We realize that it will be possible, even though difficult, to identify at least the large individual banks through such items as total assets and capital accounts, which are published in bankers directories. It is understood, however, that you will make no attempt to identify the banks, and that the data will be used only in preparing statistical tables so constructed as not to reveal the identity of individual institutions.

2. Punched machine cards showing five balance sheet items as of December 31 call dates for 1948, 1949, 1950, and 1951, for each member bank and insured nonmember commercial bank which had deposits of \$50,000,000 or more on one or more of these call dates. We will also provide a list and the identifying codes for each of these banks so as to enable you to supplement the requested information with certain data on income and valuation reserves, which we understand you will endeavor to obtain from the banks themselves or from investment manuals.

"The subject of bank capital is, of course, of constant interest and at the present time is receiving a good deal of attention by banks, bank supervisors, legislators, and the general public. As previously indicated, therefore, the Board will be very much interested in the results of your study."

Approved unanimously.

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

"Your wire August 7. Subject to formal request from Brazil, the Board approves granting of loan or loans by your Bank to the United States of Brazil, through Banco do Brasil as fiscal agent of the Brazilian Government, in a maximum amount of \$150 million at any one time outstanding on the following terms and conditions:

A. Such loan or loans to be made up to 98 per cent of the value of gold bars set aside in your vaults under pledge to you;

B. Each such loan or renewal to run for three months but no loan or renewal thereof to mature later than one year from the date of the original loan, or on September 30, 1953, whichever is earlier. (In advising Banco do Brasil of the terms of the loan you intend to state that the agreement covers one three-month loan but would add that you are prepared for the present to grant renewals of such loan, or of part thereof, for periods not in excess of three months, the last such renewal to mature no later than one year from the date of the original loan or on September 30, 1953, whichever is earlier.)

C. Each such loan or any renewal thereof to bear interest from the date such loan is made or renewed until paid, at the discount rate of your Bank in effect on the date on which such loan or renewal is made.

"It is understood that the New York Bank will indicate to the Banco do Brasil that it would be entitled to make repayments on account of the loan at any time and could subsequently again draw so as to bring the total outstanding at any one time to \$150 million, if it should so desire. It is further understood that should Brazil request an extension beyond one year, the matter would have to be reexamined to determine whether, and on what basis of amortization, further renewals should be made. It is also understood that the usual participation will be offered to the other Federal Reserve Banks."

Approved unanimously.


Secretary.