Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, June 30, 1953. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Vardaman
Mr. Mills
Mr. Robertson

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Vest, General Counsel
Mr. Youngdahl, Assistant Director, Division of Research and Statistics
Mr. Leach, Chief, Government Finance Section, Division of Research and Statistics

There was a general informal discussion of recent and prospective developments in the money market, including the reaction of the market to the reduction in reserve requirements of member banks which was approved by the Board on June 23, 1953.

Governor Robertson presented a draft of letter to the Commissioner of Internal Revenue, Washington, D. C., reading as follows:

"This refers to your letter of June 18, 1953, marked for the attention of Governor Robertson, concerning suggestions which have been made for possible changes in I. R. Mimeograph 6209, December 8, 1947, C. B. 1947-2, 26, which provides a special method to be used by banks in computing the deduction for additions to the reserve for bad debts under section 23(k) of the Internal Revenue Code.

"The first proposed formula described in your letter would:

'Authorize an annual addition to the reserve for bad debts equivalent to one-half of one per cent of the bank's conventional loan portfolio, with a ceiling on accumulations in the reserves not to exceed five per cent of such portfolio.'

"In connection with this proposal, you ask the Board for an expression of opinion as to what percentage of a bank's conventional loan portfolio would approximate an adequate bad-debt reserve. The Board finds it impracticable to suggest any specific percentage as providing an 'adequate' reserve, since such adequacy is dependent on unknown future events. All things considered, however, five per cent of a bank's conventional loan portfolio (i.e., not covered by 100 per cent Government insurance or guarantee) would be a reasonable reserve for bad debt ceiling. A four per cent ceiling would be about twice the present average ceiling under Mimeograph 6209, a decided improvement over the present allowance. For comparative purposes, net losses on loans of all member banks during the period 1931-1935 were about 12 per cent of total loans; these losses do not include losses sustained by failed banks or losses sustained by stockholders or depositors incident to arrangements for reorganizing or rehabilitating banks.

"The Board feels that it would also be desirable that the provision for a ceiling related to the loan portfolio be coupled with an additional provision that the ceiling should not be permitted to exceed a stated percentage of a bank's capital and surplus. For all commercial banks, about 23 per cent of capital and surplus at the end of 1952 was the same as 4 per cent of estimated conventional loans, and about 29 per cent of capital and surplus was about the same as 5 per cent of estimated conventional loans. A provision such as this, while not changing the maximum ceiling permitted to banks in the aggregate, would to some extent encourage undercapitalized banks to increase the basic protection afforded depositors.

"The second proposed formula described in your letter would:

'Authorize an annual addition based upon the average loss rate for a "frozen" base period of the bank with a ceiling not to exceed five times such loss rate multiplied by the bank's conventional loan portfolio. The years 1927 through 1946 are suggested as a base period reflecting a reasonable approximation of a representative business cycle.'

"This proposal does not appeal as much as the first proposal, primarily because it is not nearly as simple. In favoring the type of formula contemplated by the first proposal, the Board feels that the simplicity of the computations involved will result in more widespread utilization; as your letter notes, to date only about one-half of the banks have adopted the reserve method.

"In reply to your specific question as to what multiple should be used in the second proposal, statistical data for member banks indicate that the annual average loss rate for the years 1927 through 1946 was 0.8 per cent of total loans. It is estimated that five times this loss experience, when applied to estimated conventional loans, would provide a ceiling of 4.5 per cent of such loans--midway between a 4 and a 5 per cent ceiling under the first proposal. As already described above, these loss figures are not all-inclusive.

"Incidentally, under the second proposal a member bank could conceivably attain its ceiling in about five years, whereas under the first proposal the ceiling would not be attained for ten years with a 5 per cent ceiling, or eight with a 4 per cent ceiling.

"It is assumed that if a new formula is adopted it will be a substitute for the present Mimeograph 6209 formula. The Board feels that the addition of an alternative formula, available at the option of individual banks, would be confusing.

"Mr. Madison of the Technical Rulings Division of your Bureau has been furnished with compilations of losses of member banks during the years 1927 to 1952. However, your attention is invited to the fact that the loan and loss figures relate to all loans and not to so-called 'conventional' loans. Consequently, the relative losses to strictly 'conventional' loans would be somewhat greater.

"Please let the Board know if it can be of further assistance in the consideration of this matter."

Following a discussion, the letter was approved unanimously.

Governor Robertson then referred to the discussion at previous executive sessions of the Board with respect to the policy which should be followed with regard to nonmember bank borrowing on United States Government obligations from the Federal Reserve Banks under the last paragraph of section 13 of the Federal Reserve Act, and to the letter addressed to him under date of June 12, 1953, by Mr. Johns, President of the Federal Reserve Bank of St. Louis, setting forth the principles followed by that bank in making advances to nonmember banks.

Governor Robertson also referred to previous discussions of the question whether the bank supervisory agencies should reaffirm the existing announced policy which provides that neither appreciation nor depreciation on Group I securities will be taken into account in figuring net sound capital of a bank. In this connection, he read a letter addressed to Chairman Martin under date of June 22, 1953, by Mr. John P. Poe, President of the New Jersey Bankers Association, and an attached resolution adopted by the executive committee of the association requesting that the existing policy of the bank supervisory authorities be reaffirmed and all banking institutions so advised.

Governor Robertson then read a draft of reply to Mr. Poe which he had prepared for the consideration of the Board, and a draft of reply to Mr. Johns, which would enclose a copy of the letter to Mr. Poe. Governor Robertson said that he felt that the letter from Mr. Poe offered an opportunity to comment on both of the matters to which he had referred, that Mr. Poe would be given the right to make use of the letter for publication if he believed that would serve a worthwhile purpose, and that he (Governor Robertson) had in mind that copies of the letter would be sent not only to Mr. Johns but to the Presidents of all other Federal Reserve Banks. He suggested that copies of the incoming letters from Messrs. Poe and Johns together with the drafts of the proposed replies be sent to all of the members of the Board for their consideration and comment with a view to further discussion at another meeting of the Board.

It was agreed that the procedure suggested by Governor Robertson would be followed.

The meeting then adjourned. During the day the following additional actions were taken by the Board with all of the members except Governor Evans present:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on June 29, 1953, were approved unanimously.

Memorandum dated June 24, 1953, from Mr. Bethea, Director, Division of Administrative Services, recommending that the resignation of Thomas N. Buckley, Telegraph Operator in that Division, be accepted effective June 20, 1953.

Approved unanimously.

Memorandum dated June 26, 1953, from Mr. Bethea, Director, Division of Administrative Services, stating that Sarah F. Corbin, Charwoman in that Division, had applied for retirement on account of disability under the provisions of the Retirement System of the Federal Reserve Banks and that the Retirement System had approved the application, effective July 1, 1953.

Noted.

Letter to Mr. Powell, President, Federal Reserve Bank of Minneapolis, reading as follows:

> "In accordance with the request contained in your letter of June 19, 1953, the Board approves the appointment of Dale Wilbur Hathaway as an assistant examiner for the Federal Reserve Bank of Minneapolis.
>
> "If the appointment is not made effective July 1, 1953, as planned, please advise us."

Approved unanimously.

Telegram to the Federal Reserve Agents at all Federal Reserve Banks reading as follows:

"Referring to our April 7 letter, use of test words in telegrams covering withdrawals in the Federal Reserve Agent's Gold Certificate Fund is discontinued, effective July 1, 1953."

Approved unanimously, together with the following telegram to the Presidents of all Federal Reserve Banks:

"Referring to our April 7 letter, use of test words in telegrams covering withdrawals and transfers in the Interdistrict Settlement Fund is discontinued, effective July 1, 1953."

Mr. Carpenter reported that the Comptroller of the Currency would issue a call on July 2, 1953, on all national banks for reports of condition as of the close of business on June 30, 1953, and that, in accordance with the usual practice and the Board's letter of June 12, 1953, a call would be made on July 2 on behalf of the Board of Governors of the Federal Reserve System on all State member banks for reports of condition as of June 30, 1953.

The call to be made on behalf of the Board on July 2, 1953, was approved unanimously.

S R Carpenter
Secretary