Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, May 5, 1954. The Board met in the Board Room at 10:00 a.m.

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

Mr. Carpenter, Secretary
Mr. Sherman, 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. Young, Director, Division of Research and Statistics
Mr. Sloan, Director, Division of Examinations
Mr. Johnson, Controller
Mr. Koch, Chief, Banking Section, Division of Research and Statistics
Mr. Cherry, Legislative Counsel

In accordance with the understanding at the meeting of the Board on May 3, 1954, there had been sent to each member of the Board before this meeting revisions in the draft of letter and accompanying memorandum to be sent to Mr. Hollister, Executive Director of the Commission on Organization of the Executive Branch of the Government (Hoover Commission). The memorandum contained comments with respect to (a) Division of Authority and Responsibility Between the Board and the Open Market Committee; (b) Stock Ownership of the Federal Reserve Banks; (c) Budgetary and Audit Control of the Board of Governors and the Federal Reserve Banks; (d) Check Clearing System of the Federal Reserve Banks; (e) Government

Deposits in Private Banks; and (f) comments on a statement by Mr. Patman in his letter dated April 7, 1954, that it was his belief that "if the Federal Reserve System is overhauled and used in the interest of the people instead of the bankers, a saving of at least $2 billion could be made to the taxpayers."

Following discussion, the draft of memorandum revised to incorporate the changes sent to the members of the Board before this meeting was approved unanimously, with the understanding that it would be transmitted to Mr. Hollister with a letter prepared for Chairman Martin's signature, reading as follows:

In response to your letter of April 12, requesting comment of the Board of Governors on three letters received by your Commission from Congressman Patman, I am enclosing herewith a memorandum that deals with each of the main Patman questions and statements. I trust that this memorandum adequately meets the need of your Commission for comment by our Board.

There was presented a request for proposed travel by Mr. Young, Director, Division of Research and Statistics, to go to New York City on May 24, 1954, to attend a luncheon meeting of bank economists.

Approved unanimously.

At this point all members of the staff except Messrs. Carpenter and Johnson withdrew from the meeting.

In connection with a question on the agenda for the next meeting of the Federal Advisory Council as to the attitude of the Board on the question of using Federal Reserve funds for standby credits as indicated

in the report of the Commission on Foreign Economic Policy, Governor Mills referred to the memorandum of the meeting of the Staff Group on Foreign Interests on April 14, 1954, which stated that the Policy Group (Messrs. Martin, Szymczak, and Sproul) would consider in the near future the staff recommendation that certain of the papers on currency convertibility referred to in the memorandum be distributed to the Treasury and possibly other Government agencies. In response to Governor Mills' inquiry as to what had been done with respect to the staff recommendation, Governor Szymczak stated that the matter had been discussed with Mr. Sproul and it was agreed that the papers should not be distributed at this time to anyone other than the Presidents of the Federal Reserve Banks for their confidential information.

Before this meeting Mr. Johnson had sent to the members of the Board a budget experience report dated March 31, 1954. Mr. Johnson commented on the various matters covered by the report and they were discussed.

There was concurrence in a suggestion by Governor Evans that at the appropriate time the Board discuss the experience of the Federal Reserve Banks under their respective budgets for the year 1954.

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

Minutes of actions taken by the Board of Governors of the Federal Reserve System on May 4, 1954, were approved unanimously.

Letter to Mr. Pondrom, Vice President, Federal Reserve Bank of Dallas, reading as follows:

> In accordance with the request contained in your letter of April 28, 1954, the Board of Governors approves the designation of the following as Special Assistant Examiners for the Federal Reserve Bank of Dallas for the specific purpose of rendering assistance in the examination of State member banks only:
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> |---|---|
> | Robert R. Ball | Douglas Pond |
> | James W. Boyd | Harry L. Small, Jr. |
> | Robert A. Brown | Dick T. Richards |
>
> Appropriate notations have been made in the Board's records of the names to be deleted from the list of Special Assistant Examiners.

Approved unanimously.

Letter to the Board of Directors, Peoples Trust Company of Bergen County, Hackensack, New Jersey, reading as follows:

> Pursuant to your request submitted through the Federal Reserve Bank of New York, the Board of Governors hereby gives its written consent, under the provisions of Section 18(c) of the Federal Deposit Insurance Act, to the absorption of Glen Rock Bank, Glen Rock, New Jersey, by Peoples Trust Company of Bergen County, Hackensack, New Jersey, provided (a) the transaction is effected substantially in accordance with the plan as presented through the Federal Reserve Bank of New York and (b) that the bank agrees to strengthen its capital through the sale of new common stock, on or before December 31, 1955, in an amount mutually satisfactory to it and to the Federal Reserve Bank of New York but not less than $375,000.
>
> The Board of Governors also approves the establishment by Peoples Trust Company of Bergen County of a branch at the present location of the Glen Rock Bank, provided prior formal approval of the proposed absorption and establishment of the branch is obtained from the appropriate State authorities.

Approved unanimously, for
transmittal through the Federal
Reserve Bank of New York.

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

This refers to your letter of March 26, 1954, transmitting a request from Old National Corporation, Spokane, Washington, for the Board's approval of the divestment of such Corporation's controlling interest in Intermountain Mortgage Company and Old National Insurance Agency, Inc., by means of a so-called "spin-off" transaction. It is apparent that the Corporation will also wish to know whether the transaction will constitute compliance with the condition imposed by the Board in June 1952 in connection with the acquisition of control of Murphy Favre Mortgage Company (now Intermountain Mortgage Company) that "as soon as practicable, and in any event not later than December 31, 1957, Old National Corporation shall divest itself of any interest in the real estate and construction companies owned or controlled by Murphy Favre Mortgage Co.".

After consideration of all aspects of this transaction, the Board offers no objection to the proposed "spin-off" and has concluded that the transaction will accomplish the divestment by Old National Corporation of any interest in the real estate and construction companies owned or controlled by Intermountain Mortgage Company.

It is noted that Old National Corporation has apparently violated the condition imposed by the Board in 1952, in connection with the Corporation's acquisition of Murphy Favre Mortgage Company and its subsidiary real estate and construction companies, that such companies would continue, as in the past, to construct residential and other properties only under firm agreements with prospective owner-occupants. However, in view of the contemplated divestment by the Corporation of any interest in such real estate and construction companies as the result of the proposed "spin-off", the Board is not disposed at this time to require compliance with this condition or to consider any modification of the condition.

Approved unanimously.

Letter to The Honorable, The Comptroller of the Currency, Washington, D. C., reading as follows:

This is in response to your letter of October 9, 1953, and previous correspondence, requesting the opinion of the Board of Governors as to whether certain described transactions constitute payment of interest on demand deposits in violation of section 19 of the Federal Reserve Act, as amended (12 U.S.C. 371a).

Section 19 provides that:

"No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand..."

Section 19 also authorizes the Board of Governors "to determine what shall be deemed to be a payment of interest".

Section 2(a) of Regulation Q of the Board of Governors provides that:

"Except as hereinafter provided, no member bank of the Federal Reserve System shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit."

Section 2(a) further provides that "any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit shall be considered interest".

The following is an outline of the relevant facts, as understood by the Board. Commerce Investment, Inc., of Portland, Oregon, is a corporation engaged in originating and servicing real estate mortgage loans in that area. After mortgage loans are in "final form", they are sold by Commerce to insurance companies, including Metropolitan Life Insurance Company.

In most cases, the loans are held by Commerce from two months to twelve months before they are sold to an insurance company. In order to provide this interim financing, Commerce borrows continuously from the United States National Bank of Portland through demand notes secured by the real estate loans "in process of completion". The amount of such borrowing was in excess of $1,000,000 from September 1950 to August 1953, and at times has been in the neighborhood of $3,000,000.

Commerce also services real estate loans for Metropolitan Life Insurance Company. This arrangement involves the collection of interest and principal payments from mortgagors and the accumulation of such collections for periodic transfer to the Insurance Company. Prior to 1953, Commerce from time to time would

transfer the balances in its several collection accounts to the Insurance Company in New York. Early in 1953, pursuant to its policy of leaving funds on deposit in the localities in which they originate, the Insurance Company instructed Commerce to make the transfers from the collection accounts into a demand account in United States National Bank in the name of Metropolitan Life Insurance Company, and this procedure has been followed for the past year or more.

A memorandum in the credit files of the Bank, dated February 9, 1953, mentions that, under the new arrangement described above, the balance in the Insurance Company's account with the Bank

> "will be allowed to build up; and for this reason... it has been agreed that we will continue to charge the mortgage company (i.e., Commerce Investment, Inc.) an interest rate of 4-1/4%, but that twice each year - probably July and in January - we will compute the increase in average balance maintained with us by the insurance company and adjust the interest rate paid by the mortgage loan company by making rebate to the latter."

The Bank's credit files, under date of August 3, 1953, refer to the memorandum quoted above and reiterate that the Bank had "agreed to make to the Commerce Investment, Inc. a 1/2 of 1% interest adjustment upon net loanable funds derived from additional balances placed with us by the Metropolitan Life Insurance Company." This notation is followed by a computation by which the Bank ascertained that the average "Additional Loanable Funds" in the Insurance Company's account during the first six months of 1953 amounted to $82,930.67. The notation continued:

> "Based upon the above adjustment of 1/2 of 1% for the six-month period would amount to $207.33, which amount was remitted to the Commerce Investment, Inc. August 11, 1953."

The National Bank Examiner stated, in his letter to you dated September 23, 1953, that in all probability the "refund" for the last six months of 1953 would exceed the amount for the first six months in that year.

Although the Bank makes the payment to Commerce, the Insurance Company benefits from the arrangement to the extent that it permits Commerce, which is producing real estate loans on behalf of the Insurance Company, "to continue to function profitably and obtain the required bank credit".

Summarizing the foregoing facts, it appears that United States National Bank, in consideration of Metropolitan Life

Insurance Company's maintaining an increased demand deposit balance with the Bank, has paid to Commerce Investment, Inc., 1/2 per cent per annum of the average "Additional Loanable Funds" so maintained on deposit by the Insurance Company. In August 1953 such payment was made by the Bank through an actual remittance to Commerce.

Based on these facts, it is the opinion of the Board of Governors that the arrangement involves a payment by the Bank for the account of its depositor, Metropolitan Life Insurance Company, as compensation for the use of funds constituting a demand deposit, and therefore constitutes the payment of interest on a demand deposit by a member bank in violation of section 19 of the Federal Reserve Act and section 2(a) of Regulation Q.

Approved unanimously.

S R Carpenter
Secretary