

Minutes for September 28, 1956

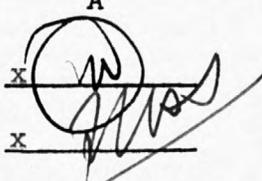
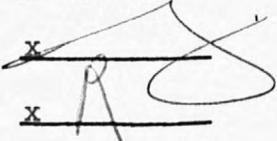
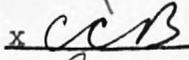
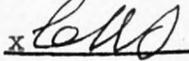
To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, if you were present at the meeting, please initial in column A below to indicate that you approve the minutes. If you were not present, please initial in column B below to indicate that you have seen the minutes.

	A	B
Chm. Martin	<input checked="" type="checkbox"/> 	_____
Gov. Szymczak	<input checked="" type="checkbox"/> _____	_____
<u>1/</u> Gov. Vardaman	_____	<input checked="" type="checkbox"/> _____
Gov. Mills	<input checked="" type="checkbox"/> 	_____
Gov. Robertson	<input checked="" type="checkbox"/> _____	_____
Gov. Balderston	<input checked="" type="checkbox"/> 	_____
Gov. Shepardson	<input checked="" type="checkbox"/> 	_____

1/ The attached set of minutes was sent to Governor Vardaman's office in accordance with the procedure approved at the meeting of the Board on November 29, 1955. The set was returned by Governor Vardaman's office with the statement (see Mr. Kenyon's memorandum of February 12, 1957) that hereafter Governor Vardaman would not initial any minutes of meetings of the Board at which he was not present. Therefore, with Governor Shepardson's approval, these minutes are being filed without Governor Vardaman's initial.

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Friday, September 28, 1956. The Board met in the Board Room at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
 Mr. Balderston, Vice Chairman
 Mr. Szymczak
 Mr. Mills
 Mr. Robertson
 Mr. Shepardson

Mr. Carpenter, Secretary
 Mr. Sherman, Assistant Secretary
 Mr. Kenyon, Assistant Secretary
 Mr. Thomas, Economic Adviser to the Board
 Mr. Leonard, Director, Division of Bank Operations
 Mr. Vest, General Counsel
 Mr. Sloan, Director, Division of Examinations
 Mr. Noyes, Adviser, Division of Research and Statistics
 Mr. Horbett, Associate Director, Division of Bank Operations
 Mr. Solomon, Assistant General Counsel
 Mr. Hackley, Assistant General Counsel
 Mr. Hexter, Assistant General Counsel
 Mr. Hostrup, Assistant Director, Division of Examinations
 Mr. Thompson, Supervisory Review Examiner, Division of Examinations

The following matters, which had been circulated to the members of the Board, were presented for consideration and the action taken in each instance was as stated:

Letter to Mr. Erickson, President, Federal Reserve Bank of Boston, reading as follows:

Reference is made to your letter of August 29, 1956, requesting approval of a new salary structure for the Federal Reserve Bank of Boston as approved by your Board of Directors on August 27, 1956.

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The Board of Governors approves the following minimums and maximums for the respective grades at the Federal Reserve Bank of Boston, effective October 10, 1956.

<u>Grade</u>	<u>Minimum Salary</u>	<u>Maximum Salary</u>
1	\$2080	\$2620
2	2160	2780
3	2240	3020
4	2480	3340
5	2680	3620
6	2980	4020
7	3340	4500
8	3700	5000
9	4170	5630
10	4680	6320
11	5390	7270
12	6130	8270
13	6980	9420
14	8080	10900
15	9360	12600
16	10340	13960

The Board approves the payment of salaries to the employees, other than officers, within the limits prescribed for the grades in which the positions of the respective employees are classified. It is assumed that all employees who are paid at salary rates below the minimum of their grades as a result of the structure increase will be brought within the appropriate ranges as soon as practicable and not later than December 31, 1956.

The Board understands that your Bank has made adequate provision in its 1956 budget to cover the increases in the salaries of employees necessitated by this new salary structure.

Approved unanimously.

Letter to Mr. Waage, Secretary, Federal Reserve Bank of New York, reading as follows:

Thank you for your letter of September 12, 1956, advising that, in response to a request from Mr. Carlos J. Canessa, President of the Banco Central de Reserva de El Salvador, Mr. John P. Jensen, Manager, Accounting Department, has been granted a leave of absence with pay for a

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period of approximately one month plus necessary travel time beginning on or about January 1, 1957. It is noted from your letter that Mr. Jensen will make a survey and study of the internal organization, accounting, control, and mechanization systems of the Banco Central. It is noted further that it is expected that Mr. Jensen will go to El Salvador in January 1957 in order to permit the Banco Central to consider possible changes in its systems prior to moving into a new building next year.

It is noted also that the financial arrangements discussed with the Banco Central provide that Mr. Jensen will be granted a leave of absence with pay with the understanding that the Banco Central will pay for his traveling and maintenance expenses.

The Board of Governors interposes no objection to the arrangements with respect to Mr. Jensen as described in your letter.

Approved unanimously.

Letter to the Board of Directors, Tompkins County Trust Company, Ithaca, New York, reading as follows:

Pursuant to your request submitted through the Federal Reserve Bank of New York, the Board of Governors approves the establishment by Tompkins County Trust Company, Ithaca, New York, of a branch in "The Plaza", a shopping center on the northeast corner of Route 13 and Meadow Street, in an unincorporated area of the Town of Ithaca, Tompkins County, New York, provided the branch is established within six months from the date of this letter and the approval of the State authorities is in effect at the time of establishment of the branch.

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

Letter to the Board of Directors, The Farmers and Merchants State Bank, Claflin, Kansas, approving, subject to conditions of membership numbered 1 and 2 contained in the Board's Regulation H, the bank's application for membership in the Federal Reserve System and for the appropriate amount of stock in the Federal Reserve Bank of Kansas City. The letter also contained the following paragraph:

The report of examination for membership made as of July 23, 1956, showed a disproportionate amount of

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classified and specially mentioned loans, as well as numerous other deficiencies in the operating methods and records of your bank. It is understood the estimated losses were charged off at the conclusion of the examination and that you have given both written and oral assurances to the Federal Reserve Bank that other matters of criticism will have corrective attention.

Approved unanimously, together with a letter of transmittal to Mr. Leedy, President, Federal Reserve Bank of Kansas City, which contained the following paragraph:

You will note that a special comment has been made in the letter to the board of directors regarding the elimination of estimated losses and the assurances which you have received concerning the correction of other matters of criticism shown in the report of examination for membership.

Letter to the Comptroller of the Currency, Treasury Department, Washington, D. C., reading as follows:

Reference is made to a letter from your office dated August 31, 1956, enclosing photostatic copies of an application to convert the Bank of Boyceville, Boyceville, Wisconsin, into a national banking association and requesting a recommendation as to whether or not the application should be approved.

Information supplied by the Federal Reserve Bank of Minneapolis about the Bank of Boyceville is favorable with respect to its financial history, adequacy of capital structure, earnings prospects, character of its management, and services to the community. Therefore, the Board of Governors recommends approval of the application.

The Board's Division of Examinations will be glad to discuss any aspects of this case with representatives of your office if you so desire.

Approved unanimously.

Letter to Mr. Galvin, Chief Examiner, Federal Reserve Bank of San Francisco, reading as follows:

This refers to your letter of September 11, 1956, transmitting copies of resolutions of the boards of

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directors of the Continental State Bank, Boise, Idaho, Walker Bank & Trust Company, Salt Lake City, Utah, and Cache Valley Banking Company, Logan, Utah, authorizing any Federal Reserve Bank to transmit copies of reports of examination of such member banks to Transamerica Corporation.

In view of the fact that Transamerica Corporation has become a holding company affiliate of the Continental State Bank, the Walker Bank & Trust Company, and the Cache Valley Banking Company, it is felt that copies of reports of examination of such banks made by your examiners subsequent to the time Transamerica Corporation became a holding company affiliate of the banks may be furnished the corporation in accordance with the authorization received from the banks, provided such reports are transmitted and receipts therefor obtained in such manner as will preserve substantially the same restrictions and conditions as to the use, recall, and disclosure for publication as those which govern the copies of reports furnished to State member banks pursuant to Form F.R. 410-45-Receipt.

The authority contained in this letter to furnish a holding company with copies of reports of examination of its affiliated State member banks is given pursuant to paragraph 8, Section 9, Federal Reserve Act, and applicable provisions of the Board's Rules of Organization. In the future such authority should be obtained from the Board in advance of formal concurrence by the Reserve Bank in requests for such copies of examination reports by bank holding companies.

Approved unanimously.

Letter to Mr. O'Kane, General Counsel, Federal Reserve Bank of San Francisco, reading as follows:

This will acknowledge your telegram of September 14, 1956 to Mr. George B. Vest, relative to the substantive information to be required, together with its form of presentation, in the matter of a request for a determination by the Board of Governors, pursuant to section 4(c)(6) of the Bank Holding Company Act, as to whether the activities of a subsidiary are so closely related to the business of banking, as conducted by a particular bank holding company or its banking subsidiaries, as to except the bank holding company from the divestment requirements of section 4.

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Please be advised that at the present time the Board does not contemplate the use of a specific form for such purpose. However, there is being prepared for transmission to all Federal Reserve Banks a general letter of instruction in this connection. It is presently anticipated that, in substance, the letter will suggest that should a determination pursuant to section 4(c)(6) be desired, the applicant will submit with such request all pertinent details of organization and operation of the company in which shares are held. This should include a statement of the nature, purpose, and activities of the company, and of the relation of its activities to the business of the bank holding company and its banking subsidiaries, together with submission of all documents of incorporation or organization and of schedules and statements deemed to have bearing on the Board's determination. Among such statements should be the balance sheets of the company or organization as of the close of each of the three fiscal years immediately preceding the request, together with income statements for the same years. The need for additional information, if any, can be ascertained during the course of the hearing.

Approved unanimously.

There were presented telegrams proposed to be sent to the Federal Reserve Banks listed below approving the establishment without change on the dates indicated of the rates of discount and purchase in their existing schedules:

Boston	September 24
Atlanta	September 24
St. Louis	September 24
Kansas City	September 24
San Francisco	September 26
New York	September 27
Cleveland	September 27
Richmond	September 27
Minneapolis	September 27
Dallas	September 27

Approved unanimously.

The Comptroller of the Currency had requested recommendations regarding applications to organize national banks at Bradenton, Florida,

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and Rogersville, Tennessee. On the basis of field investigations, the Federal Reserve Bank of Atlanta suggested an unfavorable recommendation in each case but the Board's Division of Examinations took the position that approval of the Bradenton application would be justified, subject to provision of adequate capital and satisfactory management, and submitted a draft of a letter to the Comptroller of the Currency expressing that point of view. When the files were in circulation to the members of the Board, several of the members indicated that they would favor an adverse recommendation on the Bradenton application and a recommendation for approval of the Rogersville application.

In response to the Board's request for comment, Mr. Sloan said that in the opinion of the Division of Examinations both of the applications were borderline. In the Bradenton case, the Division considered a favorable recommendation warranted because the proposed bank would be located in a section of the city which was once a separate community, the prospects for deposit growth appeared good, there were no other banks situated close to the site of the proposed bank, the area was growing rapidly, new roads and bridges would contribute to further growth, and there appeared to be a need for banking facilities. These factors, he pointed out, were reviewed in his memorandum to the Board which was circulated with the file on the application.

After stating that the Division of Examinations would be willing to go along with the Atlanta Reserve Bank on the Rogersville application, Mr. Sloan repeated that a question of judgment was involved in each case since both applications were of a borderline nature.

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In a further discussion of the applications, Chairman Martin stated that since the Board appeared to be disposed to make a recommendation contrary to that of the Atlanta Reserve Bank in the Rogersville case, it might be appropriate to afford the Bank an opportunity to submit additional material or have a representative meet with the Board.

Governor Robertson supplemented Chairman Martin's suggestion by saying that the Board might want to follow a general practice of contacting the Reserve Bank concerned whenever the Board proposed to take action different from that recommended by the Reserve Bank. He also said that, if the Board so desired, he would be willing to get in touch with the President of the Reserve Bank concerned in each such case and alert him to the fact that the Board might take action contrary to his Bank's recommendation so that the President would have an opportunity to state whether the Reserve Bank would like to express itself further before the Board acted.

There was unanimous agreement that the procedure suggested by Chairman Martin and Governor Robertson should be followed as a matter of general practice, and that the transmittal of a letter to the Comptroller of the Currency on the application to organize a national bank at Rogersville, Tennessee, would be deferred until after Governor Robertson had contacted President Bryan of the Federal Reserve Bank of Atlanta and had determined whether the Reserve Bank wanted to submit any additional information to the Board. With respect to the application to organize a national bank at Bradenton, Florida, unanimous approval was given to a letter to the Comptroller of the Currency in the following form, with a copy to the Federal Reserve Bank of Atlanta:

Reference is made to a letter from your office dated April 9, 1956, enclosing photostatic copies of an application

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to organize a national bank at Bradenton, Florida, and requesting a recommendation as to whether or not the application should be approved.

Information contained in a report of investigation of the application made by an examiner for the Federal Reserve Bank of Atlanta indicates that the proposed capitalization of the bank would be somewhat inadequate in view of the future volume of business anticipated and that the prospects for earnings are only fair. Inasmuch as arrangements have not been made for executive officers, the management of the institution cannot be regarded as satisfactory, and there does not appear to be sufficient need to justify the establishment of the bank at this time. In the circumstances, the Board of Governors does not feel justified in recommending approval of the application.

The Board's Division of Examinations will be glad to discuss any aspects of this case with representatives of your office if you so desire.

In a letter dated July 26, 1956, addressed to the Board and submitted through the Federal Reserve Bank of St. Louis, W. R. Stephens Investment Co., an Arkansas corporation located in Little Rock, Arkansas, applied for a certification by the Board under the tax relief provisions of the Bank Holding Company Act. In order to cease to be a bank holding company, the company proposed to distribute to its stockholders all of its holdings of stock in three of the four banks in which it held in excess of 25 per cent of the voting shares; and except for the tax relief provisions of the Bank Holding Company Act, the proposed distribution would subject the stockholders to a large additional income tax liability. There had been sent to the members of the Board copies of a memorandum on the matter from Mr. Hexter dated September 26, 1956, reviewing the application (the first one of its kind to be received since

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the enactment of the Bank Holding Company Act) and expressing the opinion that it was questionable whether the Board would adequately discharge its responsibility under pertinent sections of the Internal Revenue Code if such a certification was made in sole reliance upon statements made by the applicant. The memorandum urged that the Board attempt direct ascertainment of the facts in connection with this first case and recommended that such investigation be made by an employee of the Board familiar with the requirements of the applicable sections of the Internal Revenue Code. The memorandum also expressed the opinion that the Board's certification should state explicitly the basis on which it was made.

There had also been sent to the members of the Board copies of a memorandum from the Division of Examinations dated September 27, 1956, expressing the view that the Board could fully discharge its responsibilities with respect to the tax certifications if such certifications were based on facts submitted by the applicant under oath, unless the Board had reason to doubt the truthfulness of such facts, in which event an independent verification could be made through investigation by representatives of the Board at the offices of the applicant.

Governor Robertson said that he thought there was a great deal to be said for the positions taken by both Mr. Hexter and the Division of Examinations. It was his feeling that the Board should proceed very cautiously because of the complicated nature of the pertinent requirements of the Bank Holding Company Act, and that in the W. R. Stephens case the Board should attempt to have the facts verified on the basis

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of field investigation since this was the first request for determination to come before the Board. He said that he had spoken to First Vice President Deming of the Federal Reserve Bank of St. Louis and that Counsel for the Bank could be sent to the offices of the applicant next week to make an investigation. In this manner, Governor Robertson said, the case could be used as a test for the purpose of deciding what procedure it would be advisable for the Board to follow in the future, since Counsel for the St. Louis Bank could determine how difficult a task it would be to make investigations of this kind.

Mr. Vest said that he presumed Counsel for the St. Louis Bank would take with him some other person or persons from the Bank for it would not appear that a lawyer would be fully equipped to make the investigation appropriate to this kind of determination.

Governor Robertson responded that Counsel, in exploring the matter, could determine what kind of personnel might be needed. He suggested that Mr. Hexter discuss the plan further with Mr. Deming, who was now in Washington, and outline to him the views of the Board's staff.

Thereupon, it was agreed unanimously that the procedure suggested by Governor Robertson would be followed in this case.

The Board next gave consideration to a memorandum from Mr. Horbett dated September 14, 1956, submitting a revised report form and instructions for the Annual Survey of Investments of Common Trust Funds which was authorized August 11, 1955, together with a suggested letter of transmittal to

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the Presidents of the Federal Reserve Banks and a letter to the Bureau of the Budget requesting clearance of the revised form and instructions. The memorandum stated that nearly all of the revisions were of a technical character made in the light of experience with the first survey, that a draft had been sent informally to the Reserve Bank officers who handled the first survey as well as to the Bureau of the Budget and the Securities and Exchange Commission, and that the draft was accepted practically without change. It was recommended that the Division of Bank Operations be authorized to make any minor and technical changes that might be agreed upon in further discussions with the Budget Bureau.

Following comments by Governor Robertson and Mr. Horbett on the nature of the survey, Governor Mills referred to the statement made by President Bryan on behalf of the Presidents' Conference at the joint meeting of the Board and the Presidents yesterday in which Mr. Bryan expressed the concern of the Presidents that they had not been given an opportunity in all cases to comment regarding proposed statistical surveys before a final decision was reached and the instructions for conducting the survey were distributed.

In order to meet the point which Mr. Bryan had raised, the suggestion was made that even though the proposed survey would be merely a continuation of a program previously inaugurated and the revisions were of a technical nature, a letter might be sent to each of the Reserve Bank Presidents asking for their comments.

Governor Robertson said he agreed that hereafter such a procedure would be advisable but that in view of the history of this particular

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matter and the time element involved it would seem adequate if Mr. Horbett talked with Mr. Bryan as Chairman of the Presidents' Conference Committee on Research and Statistics, and endeavored to obtain clearance in that way. This would be with the understanding that if Mr. Bryan had any reservations a letter or telegram of the kind suggested could be sent to the Presidents of all Federal Reserve Banks.

At the conclusion of the discussion, it was agreed unanimously to approve the the recommendations contained in Mr. Horbett's memorandum with the understanding that Mr. Horbett would check with President Bryan and, if necessary, with all of the Reserve Bank Presidents before taking the further steps which were envisaged in his memorandum.

Mr. Hexter then withdrew from the meeting.

Pursuant to the understanding at the meeting on September 24, 1956, there had been sent to the members of the Board copies of a memorandum submitted by Mr. Vest under date of September 26 having further reference to the legislative amendments proposed to be sent to the Senate Committee on Banking and Currency in connection with that Committee's study of the Federal statutes governing financial institutions and credit. The memorandum stated that there had been eliminated from the list of proposals the various items which the Board indicated should be omitted and that requested changes in phraseology had been made in several of the other items. Submitted with the memorandum were a revised draft of the item relating to the payment of Reserve Bank earnings to the Treasury and a revised draft of the item relating to payment of interest on deposits. Also submitted was a draft of letter to Senator Robertson,

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as Acting Chairman of the Banking and Currency Committee for the purpose of this study.

With reference to four items which the Board had agreed to submit subject to a check with the Secretary of the Treasury, Chairman Martin said he had been informed by the Secretary that there would be no objection to including those items, although there had not been an opportunity to discuss them in detail. The Chairman noted that they could be withdrawn at a later date if developments made such action seem advisable. In connection with one of the four items, having to do with the issuance, redemption, and destruction of Federal Reserve notes, Mr. Leonard stated that he had discussed the legislative proposal with the Office of the Comptroller of the Currency and that the reaction was favorable.

Mr. Vest reported a telephone call which he received yesterday from a representative of the Budget Bureau who inquired whether the Board had been asked by the other Federal agencies to clear any of the suggestions which they were making to the Banking and Currency Committee. Mr. Vest said he replied that the Board had been informed of a few of the items that the other agencies were proposing but that the Board was not called upon to clear any of them.

Thereupon, unanimous approval was given to a letter from Chairman Martin to Senator Robertson reading as follows, with the understanding that copies of the letter and its enclosures would be sent to the Bureau of the Budget, the Federal Reserve Banks, the Under Secretary of the Treasury, the Comptroller of

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the Currency, the Federal Deposit Insurance Corporation, the members of the Federal Advisory Council, and the Council of Economic Advisers:

In response to your memorandum of July 20, 1956, there is submitted herewith a compilation of suggested amendments to the Federal banking laws affecting the Federal Reserve System for the consideration of your Committee in connection with its current study of all Federal laws relating to financial institutions and credit.

In accordance with the Board's understanding of the scope of your Committee's present study, the proposed amendments now being submitted by the Board relate in general to possible changes in the law with respect to operational activities and changes intended merely to eliminate obsolete provisions or to add such new provisions as seem desirable in order to clarify the law or make it more workable.

The suggestions do not cover proposals relating to policy matters or the structure and scope of authority of the Federal bank agencies, except for certain legislative proposals which were recommended by the Board during the last Congress; nor does the list of suggestions now submitted include matters of codification, such as the arrangement without change in substance of existing statutory provisions. However, with respect to such matters of codification, as well as any other matters in connection with your Committee's study, the Board and its staff will be glad to render whatever assistance the Committee may desire at any time.

Secretary's Note: The recommendations submitted with the foregoing letter were as follows:

1. Reserve Bank Organization Committee. Amendments to revise the first two paragraphs of section 2 of the Federal Reserve Act to eliminate references to the Reserve Bank Organization Committee and its functions and powers, and to repeal the thirteenth paragraph of such section 2.
2. Subscription by National Banks to Federal Reserve Bank Stock. An amendment repealing the third and fifth paragraphs of section 2 of the Federal Reserve Act, and revising the sixth and

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seventh paragraphs of that section to eliminate obsolete provisions and to make it clear that national banks organized since the date of the Federal Reserve Act must be members of the Federal Reserve System.

3. Liability Incident to Ownership of Federal Reserve Bank Stock. An amendment to section 2 of the Federal Reserve Act which would relieve member banks of the so-called "double liability" incident to their ownership of Federal Reserve Bank stock.
4. Subscription to Federal Reserve Bank Stock by the Public and the United States. An amendment repealing the eighth, ninth, tenth, eleventh, and twelfth paragraphs of section 2 of the Federal Reserve Act.
5. Original Organization of Reserve Banks. An amendment to repeal the first three paragraphs of section 4 of the Federal Reserve Act; to change the introductory part of the fourth paragraph of said section to read: "Each Federal Reserve Bank now existing shall be a body corporate and, as such and in the name designated in its organization certificate, shall have power"; to revise the ninth paragraph of such section to include provision for filling vacancies in directors now contained in the 24th paragraph of section 4; to repeal the second and third sentences of the 12th paragraph of such section; to eliminate the first sentence of the 20th paragraph and change the word "They" at the beginning of the second sentence to read "Class C directors"; and to repeal the 23rd and 24th paragraphs of such section.
6. Federal Reserve Bank Directors Must Be Residents of District. Amend section 4 to provide that every Federal Reserve Bank director shall be a resident of the District of the Federal Reserve Bank on whose Board he is serving, and that he shall cease to be a director when he ceases to be a resident of that District.
7. Continuous Service on Reserve Bank Boards or Federal Advisory Council. An amendment which would prohibit directors of Federal Reserve Banks from serving more than two consecutive terms of three years each, other than the Chairman of the Board of Directors, and would prohibit members of the Federal Advisory Council from serving more than six consecutive terms of one year each.

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8. Qualifications and Functions of Federal Reserve Agents and Assistant Federal Reserve Agents. An amendment providing for the delegation by a Federal Reserve Agent to an Assistant Federal Reserve Agent of the Agent's administrative functions; eliminating the requirement that the Federal Reserve Agent and Assistant Federal Reserve Agent have "tested banking experience"; and providing that an Assistant Federal Reserve Agent may serve during a vacancy in the office of Federal Reserve Agent as well as during his absence or disability.
9. Payment of Reserve Bank Earnings to Treasury. An amendment to provide specific direction or authority for payment to the United States by the Federal Reserve Banks of a percentage of their net earnings after expenses and dividends. This might be done through one of two methods: (1) An amendment specifically authorizing or directing the Board of Governors of the Federal Reserve System to require the Federal Reserve Banks to transfer a portion of their net earnings annually to the United States, without regard to the volume of Federal Reserve notes outstanding, or (2) an amendment requiring the Federal Reserve Banks to pay 90 per cent of their net earnings after expenses and dividends to the United States as a franchise tax, after accumulation in the case of each Bank of a surplus equal to subscribed capital. The Board of Governors expresses no opinion at this time as to which of these two methods is preferable.
10. Use by Treasury of Funds Received from Federal Reserve Banks. Repeal of the first sentence of the second paragraph of section 7 of the Federal Reserve Act.
11. Taxation of Federal Reserve Bank Stock. An amendment to remove the exemption from taxation of dividends on Federal Reserve Bank stock issued before the effective date of the Public Debt Act of 1942 so as to put such dividends on the same footing as dividends on stock issued after that date.
12. Capital Notes and Debentures Eligible for Purchase by Reconstruction Finance Corporation. An amendment to repeal the sentences contained in the first paragraph of section 9 of the Federal Reserve Act and in section 345 of the Banking Act of 1935 which relate to capital notes and debentures of the kind authorized to be purchased by the Reconstruction Finance Corporation.
13. Reports from Member Banks for Supervisory Purposes. An amendment broadening and clarifying the authority of the

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Board of Governors contained in the sixth paragraph of section 9 of the Federal Reserve Act so as to permit the reduction and simplification of the reporting requirements with respect to many banks and at the same time facilitate the collection of better statistical data.

Such an amendment would empower the Board to prescribe different forms for reports of condition and earnings and dividends for various groups of State member banks, such as reserve city banks and country banks, or large banks and small banks; to require such reports on a sample basis, instead of requiring that every State member bank report on every call; and to require or waive publication of such reports.

14. References to Section 12B of the Federal Reserve Act. An amendment to repeal the twelfth paragraph of section 9 of the Federal Reserve Act authorizing the Board to waive membership requirements in order to facilitate membership of State banks formerly required by subsection (y) of section 12B of the Federal Reserve Act to become members of the System in order to have their deposits insured; together with amendments correcting references to section 12B of the Federal Reserve Act now contained in the twelfth paragraph of section 19 and the sixth paragraph of section 25(b) of the Federal Reserve Act.
15. Stock Acquisitions in Connection with Absorptions. An amendment to paragraph 20 of section 9 of the Federal Reserve Act to provide that, with the approval of the Board of Governors of the Federal Reserve System, a member State bank may purchase and hold temporarily stock of another bank as one step in the process of absorbing such other bank through merger, consolidation, acquisition of assets and assumption of liabilities, or otherwise.
16. Removal of Certain Obsolete Provisions Regarding Members of the Federal Reserve Board. An amendment which would eliminate from the statute the provisions of the first and second paragraphs of section 10 of the Federal Reserve Act relating to the Banking Act of 1935 and the membership of the Secretary of the Treasury and the Comptroller of the Currency on the Board of Governors of the Federal Reserve System; and which would make the statement of the salary of the members of the Board conform to existing law or whatever substitute may be deemed appropriate by the Committee or by Congress.

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17. Reference to Number of Members of the Board. Amend the fourth paragraph of section 10 of the Federal Reserve Act to change a reference to the "six members" of the Board to refer to the "members" of the Board.
18. Reservation of Powers of Secretary of Treasury. An amendment to repeal the last few lines of the sixth paragraph of section 10 of the Federal Reserve Act, specifically the language "and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary."
19. Limitation on Cost of Federal Reserve Branch Buildings. An amendment which would remove entirely from the ninth paragraph of section 10 of the Federal Reserve Act the provisions thereof placing dollar limitations on expenditures for Federal Reserve Bank branch buildings, but which would retain a provision requiring Board approval of expenditures for such buildings.
20. Advances to Groups of Member Banks. An amendment to repeal section 10(a) of the Federal Reserve Act authorizing advances by Federal Reserve Banks, under certain limited circumstances, to groups of five or more member banks.
21. Simple Majority Necessary for all Board Actions. An amendment to each of various provisions of the Federal Reserve Act to eliminate the requirement that the Board action authorized by each such provision be taken only upon the concurrence of a specified number of the members of the Board. It might be regarded as appropriate to accompany these changes with a suitable amendment to the fourth paragraph of section 10 of the Federal Reserve Act (12 U.S.C. 244) which would provide that any action which the Board is authorized to take may be taken by the affirmative vote of a majority of the members present at any meeting, assuming there is a quorum present.
22. Fiscal Agency Operations of Reserve Banks. An amendment to the Federal Reserve Act providing that, notwithstanding any other provision of law, the operations of a Federal Reserve Bank pursuant to authority of law as fiscal agent, depository or custodian of the United States or any instrumentality thereof or of any other organization shall be subject to the supervision and regulation of the Board of Governors of the Federal Reserve System.

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23. Incorrect Reference to Section 20 of the Federal Reserve Act. Amend section 11(e) of the Federal Reserve Act to make the inaccurate reference to section 20 of the Act refer to section 19, and to change "national banking associations" to "member banks".
24. Revocation of Trust Powers of National Banks. An amendment to authorize the Board of Governors, on complaint by the Comptroller of the Currency, to revoke trust powers of national banks if it is determined, after hearing, that such powers are being unlawfully or improperly exercised.
25. Elimination of References to Bonds Issued Under Home Owners' Loan Act and Bonds of Federal Farm Mortgage Corporation. An amendment to eliminate references to bonds and obligations of the Federal Farm Mortgage Corporation and the Home Owners' Loan Corporation and bonds issued under the Home Owners' Loan Act, as now contained in various provisions of the Federal Reserve Act.
26. Elimination of References to National Agricultural Credit Corporations. An amendment to repeal references to the National Agricultural Credit Corporations contained in various provisions of the Federal Reserve Act.
27. Repurchase Agreements of Federal Reserve Banks. An amendment specifically stating, and thus making it clear, that Federal Reserve Banks are authorized to make repurchase agreements with respect to Government securities and that such activities of the Reserve Banks are subject to the direction of the Federal Open Market Committee.
28. Settlement Fund. An amendment to (1) eliminate obsolete provisions, i.e., references to the Assistant Treasurer of the United States and to the Subtreasuries of the United States; (2) provide specifically that deposits in the Fund may include deposits by the Treasurer of the United States for the credit of any Federal Reserve Bank and that withdrawals from the deposit may be made in the form of payment to the Treasurer of the United States as well as to a Federal Reserve Bank or a Federal Reserve Agent; and (3) provide that the term "gold certificate" shall include credits payable in gold certificates.
29. Federal Reserve Notes. (1). An amendment to repeal various provisions of section 16 of the Federal Reserve Act relating to the "redemption" of Federal Reserve notes and the maintenance in the Treasury of a redemption fund in gold certificates for that purpose.

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- (2). An amendment to provide that unfit Federal Reserve notes shall be returned to the Treasury of the United States for destruction under regulations prescribed by the Secretary of the Treasury, in lieu of the existing provision that unfit notes "shall be returned by the Federal Reserve Agents to the Comptroller of the Currency for cancellation and destruction".
- (3). A number of amendments to eliminate obsolete and redundant provisions, to simplify and clarify certain provisions, to bring other provisions into line with existing terminology and practice, and to rearrange sentences and paragraphs to make the entire section more logical.
30. Federal Reserve Bank Notes. An amendment to repeal subparagraph "Eighth" of the fourth paragraph of section 4 of the Federal Reserve Act and all of section 18 of the Federal Reserve Act, relating to the issuance of Federal Reserve Bank notes and exchanges of United States bonds bearing the "circulation privilege".
31. Elimination of Obsolete Provision Regarding Reserve Requirements. An amendment to repeal the paragraph in section 19 of the Federal Reserve Act after the sixth paragraph thereof.
32. Payment of Interest on Deposits. Amendments to section 19 of the Federal Reserve Act to eliminate the words "directly or indirectly by any device whatsoever" from the language prohibiting interest on demand deposits and to make it clear that the term "interest" shall include only cash payments made, or credits given, by a bank for the account or benefit of a depositor; together with an appropriate amendment to make certain that the same limitations as to payment of interest shall apply to both member and nonmember insured banks, either by an explicit statement in the law as to both types of banks as to whether absorption of exchange charges shall be deemed a payment of interest, or by a provision authorizing either the Board of Governors or the Federal Deposit Insurance Corporation to define the term "interest" for both classes of banks.
33. Interest on Demand Deposits of Savings Bank and of Public Funds. An amendment to eliminate the twelfth paragraph of section 19 of the Federal Reserve Act.

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34. Reserves Against Deposits of Public Moneys. An amendment repealing the provisions of the First and Second Liberty Bond Acts which state that reserves need not be maintained against deposits of public moneys, and also revising the fourteenth paragraph of section 9 of the Federal Reserve Act to state simply that member banks shall be required to maintain the same reserves against deposits of public moneys by the United States as they are required to maintain against other deposits.
35. Obsolete Provision as to Loans to Executive Officers of Member Banks. An amendment eliminating the provision of section 22(g) of the Federal Reserve Act which states " * * * That loans made to any such officer prior to June 16, 1933, may be renewed or extended for periods expiring not more than five years from June 16, 1939, where the board of directors of the member bank shall have satisfied themselves that such extension or renewal is in the best interest of the bank, and that the officer indebted has made reasonable effort to reduce his obligation, these findings to be evidenced by resolution of the board of directors spread upon the minute book of the bank: * * *"
36. Loans to Executive Officers - Dollar Exemption. An amendment to section 22(g) to increase the present \$2,500 exemption from the prohibition on loans by member banks to executive officers to \$5,000.
37. Investment by National Banks in Foreign Financing Corporations. An amendment to repeal the fourth paragraph of section 25 of the Federal Reserve Act.
38. Powers of Foreign Branches of National Banks. An amendment adding a new provision to section 25 of the Federal Reserve Act (12 U.S.C. 601-604) which would authorize the Board, by regulation, to permit foreign branches of national banks to exercise such further powers as may be usual in connection with the business of banking in the place where the foreign branch is located, subject to suitable safeguards to assure that such foreign branches would not engage in such business as investment banking or manufacturing. Such new provision would be added to the last paragraph of section 25 (12 U.S.C. 604).
39. Procedure for Removal of Directors and Officers. An amendment to section 30 of the Banking Act of 1933 relating to removal of directors or officers of member banks, to eliminate the participation in the proceeding by the Federal

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Reserve Agent. With such a change the Board of Governors of the Federal Reserve System, rather than the Federal Reserve Agent, would issue the warning when a State member bank appears to have violated the law or engaged in unsafe or unsound practices. In the event the violation of law or unsafe or unsound practice was repeated after the warning, a hearing by the Board to determine whether to remove the officer or director could be instituted without the formality of a certification by the Federal Reserve Agent which is now required.

40. Bank Mergers. An amendment to section 18(c) of the Federal Deposit Insurance Act to require the prior approval of the appropriate Federal bank supervisory agency in the case of any bank merger or consolidation, whether or not such merger or consolidation results in a diminution of capital or surplus; together with an express requirement that the appropriate banking agency shall take into consideration the usual banking factors and also whether the proposed transaction would tend to lessen competition unduly or tend unduly to create a monopoly, with a provision requiring the agency to seek the views of each of the other two banking agencies with respect to the question of competition and authorizing such agency to request the opinion of the Attorney General with respect to such question.

Under date of September 11, 1956, Congressman Teague, Chairman of the House Committee on Veterans' Affairs, wrote to Chairman Martin making certain inquiries about mortgage interest rates and monetary policy. A draft of reply prepared by Mr. Thomas, consisting of a letter and attached memorandum, had been distributed to the members of the Board prior to this meeting.

Following a discussion, the proposed reply to Congressman Teague, prepared for Chairman Martin's signature, was approved unanimously subject to editing by Mr. Thomas on the basis of certain comments made at this meeting.

Secretary's Note: The letter and enclosed memorandum were sent today in the following

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form, with copies to the Presidents of all Federal Reserve Banks for their information:

Your letter of September 11 requests comments upon questions that raise some broad and basic issues about the current economic situation. The Federal Reserve has been acutely aware of the complexities of these issues and the difficulty of assessing the present situation and reaching judgments about the underlying forces and trends. The Federal Reserve System has responsibility in the limited area of bank credit for helping to maintain conditions conducive to orderly and sustainable economic development as well as stability in the value of the dollar. We are, therefore, concerned with the questions that you have raised.

Accordingly, the attached memorandum has been prepared by the Board's staff. While it is a lengthy reply to your questions, the considerations involved are so basic and far reaching that deep and thorough probing is needed to reveal their true character. I hope you will find the memorandum a helpful one.

Mortgage Interest Rates and Monetary Policy

Congressman Teague's letter of September 11, 1956, presented in effect two major questions for comment, namely:

(1) Whether the 4-1/2 per cent interest rate on VA mortgages can be maintained under existing conditions in the credit markets and prevailing credit policies, and

(2) What is the explanation for variations in discounts on such mortgages in secondary markets throughout the country?

Reasons for these developments rest largely in the general economic and credit situation that now prevails, not only in this country, but throughout the world. Certain special features of the market for VA mortgages are also important. Some views on the general subject of the state of the mortgage market were expressed by the Chairman of the Board of Governors and others at hearings of a Subcommittee of the Senate Banking and Currency Committee last November. Although the situation now differs in some particulars, the general considerations are still much the same as then.

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Although the total number of new housing starts this year has been somewhat below last year's record level, it is still large compared with previous years and also relative to the current rate of new family formation. The value of new homes constructed, moreover, has been larger than in any previous year, except 1955, and so has the volume of new home mortgage loans made. This reflects in part higher prices and in part the larger homes being built and sold. To a considerable degree, the demand for smaller houses is being met from the very large number that were built in earlier years and come on the market as owners shift to larger houses. Total mortgage debt outstanding increased by \$8 billion in the first half of 1956, close to the record figures of the two preceding years. Although the aggregate amount of FHA and VA loans made has been somewhat below last year's record level, it has compared favorably with that of other years. The volume of nonresidential construction has been at record levels, and the total of all construction has been utilizing to the full most of the materials and labor available in this sector of the economy.

Features of Market for Guaranteed Mortgages

As a background for an understanding of the current situation in the mortgage market, it is necessary to keep in mind the particular benefits accruing to veterans from the VA mortgage guarantee program. The guarantee made it possible for veterans to obtain mortgage loans of much longer maturities and for much larger proportions of purchase price than would otherwise have been possible. In particular, the VA guaranteed mortgages were able to tap the national market that had developed around FHA insured mortgages. This enabled veterans in communities and regions where the supply of mortgage money was scarce and loan conditions tended to be restrictive to obtain loans in larger amounts and on more favorable terms than would otherwise have been available to them. This has been the great contribution of the VA program. A large number of the veterans and a great many builders have benefited from it.

With respect to the level of interest rates on VA loans, it is necessary to recognize that the supply of funds available for such loans depends in the final analysis upon the volume of savings in the country, on the one hand, and, on the other, upon the total volume of investment demands, including mortgage demands, for those savings. The general

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level of interest rates reflects the interplay of these basic forces upon each other. Variations in these factors are the result of developments in all aspects of the economy, as determined by the decisions of millions of individuals and businesses. Governmental policies can influence them to some degree, but undue interference with the operation of the forces of demand and supply in free markets will frequently cause more difficulty than it can solve.

When the Veterans' Readjustment Act was enacted in 1944 the supply of savings available for investment was extraordinarily large. National income, generated by war activities, was very high. At the same time, consumers were restricted in their spending, and many of them used the income they could not spend to repay debt as well as to purchase Government securities. With strong competition among lenders for loans, interest rates on mortgages were bid down and at the time the "G.I. Bill" was being drafted and enacted FHA mortgages were being made freely at 4 per cent, and mortgages carrying higher rates were selling at premiums. Therefore, the 4 per cent maximum rate for VA mortgages might then have been properly regarded as a competitive market rate. In the case of FHA insured loans, likewise, it may be said that the statutory ceiling, which is higher than that permitted under existing regulation, was designed to permit market flexibility in actual rates charged.

Current Large Demands for Credit

The current situation is quite different. Total demands for all types of credit--long and short, public and private--have been unusually large in the past two years. According to Department of Commerce estimates, the total volume of all debt increased by more than \$50 billion in 1955, much more than in any previous peace-time year.

In 1956, credit demands in the aggregate have continued large. Although some demands, particularly for consumer installment credit and borrowing by the Federal Government, have been much smaller than in 1955, others have continued at a high level. As already mentioned, the volume of mortgage loans extended has been larger than in any year except 1955. Particularly heavy and increased demands have come from industry for plant and equipment expenditures to maintain and expand the productivity of the economy. New capital issues by corporations in the first nine months of 1956 are expected to total about \$7.5 billion, compared

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with \$6 billion in the same period of last year, and additional new issues scheduled for offering indicate that this year's total will exceed that of any previous year. In addition, business loans at banks have continued to increase at a rapid rate, reflecting this year considerable borrowing for long-term purposes by businesses unable or unwilling to borrow in capital markets, as well as customary short-term borrowing for working capital. Reflecting in part the need for facilities to serve the tremendous new housing developments that have been constructed in recent years, commercial building has been large. For this reason and others, large amounts of funds have been borrowed by State and local governments to build schools, streets, roads and other community facilities.

Expenditure of these borrowed funds, together with a continued high and expanding volume of spending out of current income, is now utilizing the human and physical resources of the economy as fully as is practical. In fact, there is evidence in rising prices, particularly for industrial materials and products, that demands are in excess of available resources. A more rapid increase in total spending, whether for consumption or investment, would create a further excess of demand over available supply and result in added price pressures.

In the face of all these record-breaking demands for capital and credit, the supply of savings available to finance them has increased only moderately, and only a portion of these are available for mortgage lending. The net flow of funds to the principal savings institutions that provide the major sources of funds for mortgages as well as for corporate and Government securities, has increased much more slowly in recent years than have aggregate credit demands.

Resulting Rise in Interest Rates

As a consequence of the pressures of heavy demands for credit and capital upon the limited although still growing supply of savings, interest rates have risen in all sectors of the credit market. United States Government long-term bonds are selling in the market to yield 3-1/4 per cent, compared with little over 2-1/2 per cent two years ago; and 5-year bonds are yielding 3-1/2 per cent at current prices, owing in part to sales by banks that are seeking funds to meet loan demands. New issues of high-grade public utility

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bonds have recently been sold to yield over 4 per cent. Yields on tax-exempt revenue bonds issued by State and local government instrumentalities have been around 3-1/2 per cent, providing a very high effective yield for investors in the medium and upper income-tax brackets.

Short-term rates, which had previously declined more, have risen more than long-term rates. The margin between short-term and long-term rates is narrower than it has been at any time in 25 years and some short rates are above long-term yields for the first time in that period. These short-term loans and investments now offer competition for funds that might ordinarily seek long-term investment. Although interest rates in general have risen considerably from previous low levels, they are still not high compared with previous periods of high-level activity and full employment.

Mortgages must compete with other demands for available savings, and interest rates on mortgages must be related to rates lenders can obtain elsewhere. Mortgage rates are necessarily higher than those on high-grade securities because of the cost of servicing and of marketing mortgages in large numbers of small units, as well as because of risks and costs of possible delinquencies and foreclosures. Although current statistics are not available, it is common knowledge that interest rates on the so-called conventional, uninsured mortgages have risen in the past two years. Under these circumstances, the 4-1/2 per cent ceiling on the VA mortgages has acted to limit the demand for these mortgages relative to that for other types of investment. It is to be expected that guaranteed mortgages would have a preferred position in the market relative to other mortgages and, therefore, be marketable at lower rates of interest. This has continued to be the case, but the increased spread between contract rates has tended to wipe out this advantage. There has been a considerable shift in the preference of lenders from guaranteed and insured mortgages to conventional mortgages, largely because of the widening of these interest rate differentials. This shift has been reflected particularly in commitments for future purchases, which were greatly over-extended in 1955. These over-extensions are partly responsible for weaker markets this year.

Although discounts on the guaranteed and insured mortgages have in part compensated lenders for the differences in contract rates, the handicap has not been wholly overcome, because of restrictions placed on discounts by law and by the guaranteeing

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agency, the reluctance of originators of the mortgages to sell them at discounts, and also a feeling on the part of some lenders against the acquisition of obligations at a discount. Thus it is unquestionably true that the interest rate ceiling on guaranteed mortgages is discouraging the flow of funds into such mortgages. For the time being, the effect of this has been primarily on builders rather than on veterans. Reports indicate that in most areas homes are still available to veteran purchasers under liberal financing terms. In time, however, continuation of existing rate differentials will make it difficult for veterans to continue to obtain the benefits the guarantee was designed to give them.

Role of Monetary Policy

With this background, the bearing of credit policies upon the situation may be explained. It should be recognized that Federal Reserve policy is concerned fundamentally with the availability of reserve funds to commercial banks and that these banks specialize to a large extent in providing short-term bank credit to meet the needs of businesses and individuals for working cash balances. Of the more than \$50 billion of total debt expansion in 1955, only \$5 billion was supplied through expansion in total commercial bank credit. Bank loans increased by over \$12 billion, but banks obtained some of the funds for this purpose by selling about \$7 billion of U. S. Government securities to nonbank investors, rather than by the creation of new money.

The responsibility and the aim of Federal Reserve operations is to make available to banks sufficient basic reserves to meet seasonal variations in monetary needs and to permit expansion in bank credit consistent with sustainable growth for the economy as a whole, and no more. Only in this way can growth be made possible while inflation is avoided. It is not the task of the Federal Reserve to create additional money to meet investment demands in excess of the available supply of savings or to supply any particular investment demand. To do so, in a period when savings are being fully invested and the resources of the economy are being fully utilized, would create demands in excess of available goods and services and thus result in inflation. In general, the varying pressures of credit demands are more responsible for fluctuations in interest rates than are changes in the available supply of funds. This supply depends largely on the volume of savings, supplemented by Federal Reserve operations which, though flexibly

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adjusted to changing conditions, are directed toward the prime objectives of sustainable economic growth and protection of the value of the dollar.

Conclusion

It follows from this description of the current situation that interest rates on mortgages have risen because of the pressures of excessive demands for credit and capital upon the available supply of savings. Under these circumstances a rise in interest rates can be prevented only by creating additional money, which would be inflationary and result in rising prices, because the available resources of the economy are already being fully utilized. Guaranteed mortgages for veterans have had particular difficulty in maintaining their market because the fixed rate of interest on such mortgages has become out of line with rates obtainable on other investments.

Regional Variations in Mortgage Discounts

With respect to the question about regional variations in discounts on VA mortgages, these may be said to reflect regional differences in the availability of mortgage funds relative to the need for them, in the cost of creating and marketing mortgages, and in the risks and costs of possible delinquencies and foreclosures. Before the institution of insurance or guarantees on mortgages, regional differences in interest rates were much greater than they are now, but there are still some differences. To attempt to eliminate them arbitrarily by law or regulation would tend to deprive certain areas of housing credit by closing off national markets for mortgages in high interest rate or large discount areas, which are the regions most in need of outside funds. It is essential to permit the operation of the forces of the market in order to obtain the most effective and equitable allocation of available funds.

Chairman Martin said that he was continuing his discussions with the Secretary of the Treasury on the matter of a possible increase in the maximum rates of interest on time and savings deposits prescribed by Regulation Q, Payment of Interest on Deposits. In a further comment

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he expressed the view that it would be advisable in any event to postpone action until after the forthcoming Treasury financing had been completed.

Agreement was expressed by the other members of the Board with Chairman Martin's view that no action should be taken on the maximum rates of interest until the Treasury financing was out of the way.

Messrs. Leonard and Horbett then withdrew from the meeting.

In June 1956, the Midland National Bank of Minneapolis, Minnesota, submitted through the Federal Reserve Bank of Minneapolis a request for the Board's views on whether it would be permissible to classify as a "savings deposit" under Regulation Q a deposit evidenced by a "savings certificate" in the form submitted with the request. After discussing the matter, the Board sent letters to the Presidents' Conference and the Federal Advisory Council under date of July 23, 1956, asking for their views on the matter. At subsequent meetings with the Board, both the Presidents' Conference and the Council expressed the view that a deposit evidenced by such a savings certificate should not be classified as a savings deposit.

By letter dated August 22, 1956, Midland National Bank submitted through the Federal Reserve Bank of Minneapolis two alternative forms of savings certificate somewhat different from the form originally submitted. In a memorandum dated August 29, 1956, copies of which had been distributed to the members of the Board before this meeting, Mr. Shay, Assistant General Counsel, took the position that the second alternative form of

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savings certificate would comply with the definition of "savings deposit" in Regulation Q. A deposit evidenced by the certificate would be payable only to the depositor, and the certificate apparently would be used only for deposits of persons and organizations eligible under the regulation to have savings deposits. In addition, the certificate would reserve in the bank the right to require sixty days' written notice before any payment of the certificate. Mr. Shay's memorandum stated that if it should be the Board's conclusion that such certificates should not be used for savings deposits, it would seem necessary to amend Regulation Q in order to justify the position that such a certificate would not fall within the definition of the term "savings deposits".

In reviewing the matter at the request of the Board, Mr. Vest said that the form of the modified savings certificate seemed to eliminate any technical question of conformity with Regulation Q, but that there was still the basic question of whether a certificate having a definite maturity should in any circumstances be considered eligible for classification as a savings deposit.

Governor Mills commented that this request again involved the question of "hybrid" instruments. He said he felt strongly that the Board should concur in the opinion expressed by the Presidents' Conference and the Federal Advisory Council and that the certificate, even in the modified form, should not be classified as a savings deposit.

After other members of the Board had expressed agreement with the view stated by Governor Mills, Governor Robertson pointed out that

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on the basis of Mr. Shay's memorandum it would appear that the Board would have to amend Regulation Q to make it clear that deposits represented by certificates with fixed maturities could not be classified by member banks as savings deposits. He went on to say that he would not be averse to taking the position suggested by Governor Mills if the Board contemplated an appropriate amendment of the regulation.

Mr. Vest then suggested that the Board might inform the Midland National Bank that it did not look with favor on the use of certificates of the kind in question as representing savings deposits and that the Board expected to publish in the Federal Register a notice of a proposed amendment to Regulation Q which would clarify the Board's position.

In further discussion, Governor Mills said that at least one member of the Federal Advisory Council felt quite strongly that Regulation Q, in its present form, was too detailed and that the Board should express a broader concept in the regulation which would allow member banks more latitude in defining savings deposits and arriving at related decisions as to forms and procedures. Governor Mills added that personally he did not subscribe to that point of view.

Mr. Hackley stated that there was some opinion among the Board's legal staff that even if savings deposits were permitted with a definite fixed maturity, the purposes of the Board's regulation would not be defeated as long as other sections of the regulation continued to be applicable, including the provisions which restrict savings deposits to limited categories of depositors.

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With reference to Mr. Hackley's comment, Mr. Vest said it was his personal view that savings deposits should be considered in a somewhat different category from time deposits and that it was not advisable to permit a breaking down of the present distinctions merely because of language which technically would meet the requirements of the Board's regulation.

Along the same lines, Governor Mills pointed out that over the years savings accounts and time certificates of deposit have been cast in different forms. If member banks should be permitted to recast savings deposits in the form of time certificates, he felt that unnecessary confusion might be created.

At the conclusion of the discussion, unanimous approval was given to a letter to Mr. McConnell, Vice President of the Federal Reserve Bank of Minneapolis, in the following form, with the understanding that a notice of a proposed amendment to Regulation Q reflecting the views expressed by the Board at this meeting would be prepared and submitted to the Board for consideration prior to publication in the Federal Register:

With your letter of August 23, 1956, you forwarded a letter of August 22 from the Midland National Bank of Minneapolis, Minneapolis, Minnesota, in further reference to whether a deposit evidenced by a form of "Savings Certificate" would be eligible for classification as a "savings deposit" under section 1(e) of Regulation Q as amended effective May 16, 1955.

The form of proposed certificate enclosed with the national bank's letter of August 22 provides for an initial fixed maturity, apparently six months from the date of the certificate, and further provides that if not

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presented at that time its maturity will automatically be extended for successive periods of six months each, but with a provision authorizing the depositor to establish a different maturity date within any such period by 60 days' written notice to the bank. The bank's letter indicates that it would be willing to add a further provision under which the bank, at its option and regardless of maturity, might require similar written notice of 60 days before paying the deposit.

In the opinion of the Board, the classification as "savings deposits" of deposits represented by certificates providing for fixed maturities, such as that described above, whether or not modified as suggested by the bank in this case, would tend to create undesirable confusion between ordinary time deposits on the one hand and true savings deposits on the other. Traditionally, savings deposits have consisted of deposits which do not have a prescribed or fixed maturity. Accordingly, the Board does not look with favor upon the use of certificates of the kind here in question as representing savings deposits; and the Board expects soon to publish in the Federal Register notice of a proposed amendment to Regulation Q which would make it clear that deposits represented by certificates with fixed maturities may not be classified by member banks as savings deposits.

There had been sent to the members of the Board copies of a memorandum from Mr. Hackley dated September 5, 1956, regarding the status of Otto Bremer Company, St. Paul, Minnesota, as a bank holding company under the Bank Holding Company Act of 1956.

Following a statement by Chairman Martin that, after reading the material submitted with Mr. Hackley's memorandum, he was inclined to concur in the view that Otto Bremer Company should be regarded as a bank holding company for purposes of the Act, Governor Robertson said that he had not yet had an opportunity to review the matter carefully and it was agreed to hold the matter over for further discussion at a meeting of the Board next Monday.

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Messrs. Hackley, Hostrup, and Thompson then withdrew from the meeting.

The next item to be considered by the Board was a memorandum from the Legal Division, the Division of Research and Statistics, and the Division of Examinations dated August 31, 1956, concerning possible changes in Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange, with respect to (1) convertible bonds and debentures, (2) the loan purpose statement, and (3) loans of trust funds. With the memorandum, copies of which had been distributed to the members of the Board, there were submitted separate memoranda on each of the three subjects, including comments received from the Federal Reserve Banks.

With respect to loans in connection with convertible bonds and debentures, an amendment to Regulation U was suggested under which a bank loan to purchase a convertible security or other nonregulated or exempted security would be nonregulated up the point of conversion, exchange, or sale of such security and the acquisition of a registered stock. At that time the total loan - including any additional sums advanced to acquire the registered stock - would become regulated and the borrower would have to "bring-up" the margin on the total credit to the standard regulatory requirement. The proposed amendment now submitted to the Board reflected changes of a technical nature suggested by the comments of the Federal Reserve Banks, the majority of whom either favored the proposal or indicated no objection.

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Governor Szymczak stated that in view of the Reserve Bank comments and the views expressed by other parties, including the American Telephone and Telegraph Company and the New York Stock Exchange, with whom the matter was discussed informally, he would favor the adoption of such an amendment.

Governor Mills said that he had some doubt whether the problem was of sufficient importance to impose on banks the mechanical difficulties involved in following their accounts with such exactitude that at a particular time, i.e., when the conversion privilege was exercised, they would have to raise the margin requirement.

Governor Szymczak then made a further statement in which he summarized the manner in which the suggestion originally was made, the consideration given to the problem, the discussions which were held with parties from within the System and from the outside, and the nature of the comments by the Federal Reserve Banks, which in several instances reflected contacts with local commercial banks. He said that he did not consider the matter extremely important or urgent, but that the proposal appeared to be in the direction of equity as between brokers and banks and thus far there was no real indication of serious objection on the part of those who would be affected by the amendment.

In response to questions by Chairman Martin concerning distinctions between Regulation U and Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, Mr. Solomon said that it was impossible under the law as

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presently written to put banks and brokers on exactly the same basis but that the proposed amendment would be in that direction. He went on to say that under the law convertible bonds and debentures could be dealt with more strictly than in the proposed amendment since they could be treated as registered securities from the outset. However, that would raise all of the problems Governor Mills had mentioned, and it was largely as a result of the consideration given to those problems that the current proposal was worked out. The American Telephone and Telegraph Company, which is the largest issuer of convertible debentures, had indicated that such a proposal would not interfere with its operations and the Federal Reserve Bank of New York would have been willing to go along with an even stricter proposal. In all the circumstances, it was felt that this proposal would solve reasonably well the problem that had been presented to the Board. It would attempt to preserve as much freedom of action as possible for the banks while bringing about a more equitable situation from the standpoint of the brokers.

Governor Mills then made a further statement in which he said that as far as the public interest was concerned, Regulation U in its present form seemed to him generally consistent with the proper responsibilities of the Board in that it did not deny the holder of convertible debentures access to credit. He also said that the proposed amendment might help the broker to maintain a more intimate customer relationship and that he could understand how that might have some advantages from the broker's point of view.

Thereupon, Governor Mills' comments having been noted, it was agreed that the staff should prepare an appropriate notice

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of proposed amendment to Regulation U for publication in the Federal Register and for transmittal to the Federal Reserve Banks for their further comments and suggestions.

The second possible change in Regulation U would provide that reliance by a lending bank on a "purpose" statement would be permissible only if such statement described the purpose of the loan specifically and affirmatively. The reactions of the Federal Reserve Banks and of the commercial banks that they contacted on this possible change reflected a divergence of opinion, but the weight of Reserve Bank sentiment was opposed to the proposal.

In reviewing the matter, Governor Szymczak said that he doubted the advisability of making such an amendment at this time. He noted that the comments of the Reserve Banks on a similar proposal had been requested in 1955, that only a few of the Federal Reserve Banks favored any strengthening of the "purpose" statement at that time, but that a draft of possible amendment was again submitted to the Banks in March of this year along with a draft of possible amendment relating to convertible bonds and debentures in the thought that the two amendments might be made together if regarded favorably.

In a further discussion of the matter, during which it was noted that some of the Reserve Banks were quite vigorous in their objection to such an amendment, the view was expressed that while the present provisions of Regulation U permitting reliance on a "negative" statement might be rather meaningless, the need for a strengthening of the provisions

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did not appear to be urgent and it seemed doubtful whether the circumstances required such an amendment at this time.

At the conclusion of the discussion, it was agreed unanimously not to publish the suggested amendment in the Federal Register at this time.

The third possible change in Regulation U related to a question raised with the Board by The Chase Manhattan Bank of New York in January 1956 regarding an interpretation by the Board in December 1955 that Regulation U would be applicable to employee stock-purchase loans made by the bank as corporate trustee of the employee retirement trust of an investment company. The trust instrument, which specifically authorized such loans from the funds of the trust, provided that investment in such loans should be solely in the discretion of the individual co-trustees of the trust and that the corporate trustee should act in accordance with the directions of the individual co-trustees. The interpretation by the Board followed the principle of interpretations made by the Board in 1946 to the effect that Regulation U was applicable to the activities of a bank when acting in its capacity as a trustee. The Board having advised The Chase Manhattan Bank that it would reconsider the matter, several possible alternatives were presented to the Federal Reserve Banks for comment, and the majority of the Banks expressed the view that the regulation should not apply to bank loans of trust funds. None of the Banks indicated that there was a need for extending the provisions of Regulation U to presently exempt lenders.

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At the request of the Board, Mr. Solomon described the circumstances in which the question had arisen, the position taken by the Board in its 1946 interpretations, and the views of the Federal Reserve Banks. He said that personally he had some difficulty in finding that there was any great need for changing the regulation on the point in question.

Governor Szymczak said that although he was inclined to concur from a technical standpoint in the position of Mr. Solomon, he was somewhat impressed by the position of the Federal Reserve Banks which was generally favorable toward a relaxation of the Board's previous interpretations of Regulation U.

After a further discussion, which was concerned principally with the circumstances surrounding the request of The Chase Manhattan Bank, agreement was expressed with a suggestion by Chairman Martin that the subject be held over for further consideration.

The members of the staff then withdrew and the Board then went into executive session.

Chairman Martin later advised the Secretary's Office that during the executive session consideration was given to a memorandum dated September 13, 1956, from Mr. Marget, Director, Division of International Finance, regarding a request by the Government of the Sudan, transmitted through the Department of State, for a technical mission staffed by Federal Reserve personnel to go to the Sudan later this year to give advice with regard to the establishment of a central bank. Mr. Marget's memorandum indicated that on the basis of informal exploration by the Board's staff, President Powell of the Federal Reserve Bank of Minneapolis and two economists from

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the Federal Reserve Bank of New York would be available for such an assignment. Chairman Martin stated that after discussing the matter the Board referred it to him (Chairman Martin) with the understanding that he would discuss the proposed mission with Chairman Perrin of the Federal Reserve Bank of Minneapolis. Chairman Martin also advised the Secretary's Office that he later had a discussion with Chairman Perrin and was awaiting further word with him.

The meeting then adjourned.

Secretary's Note: It having been ascertained, pursuant to the action taken by the Board on September 20, 1956, that Mr. Robert P. Briggs, Executive Vice President of Consumers Power Company, Jackson, Michigan, would accept appointment, if tendered, as Class C director of the Federal Reserve Bank of Chicago for the remainder of the term expiring December 31, 1958, the following telegram was sent to Mr. Briggs today:

Board of Governors Federal Reserve System has appointed you Class C director Federal Reserve Bank of Chicago for remainder of term expiring December 31, 1958, to succeed Mr. Carl E. Allen, Jr., when he takes office as president of Chicago Bank October 1. Your acceptance by collect telegram would be appreciated.

It is understood you are not director of any bank and do not hold public or political office. Should situation change in these respects during your tenure, please inform Chairman Chicago Bank.

Please indicate how you wish your name and principal business affiliation to be shown in Board's announcement and publications.

Secretary's Note: Pursuant to the recommendation contained in a memorandum dated September 25, 1956, from Mr. Sloan, Director, Division of Examinations, Governor

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Shepardson approved on behalf of the Board yesterday the granting of an advance of 10 days' sick leave to Henry Benner, Assistant Director of that Division, covering the period September 10-21, 1956.

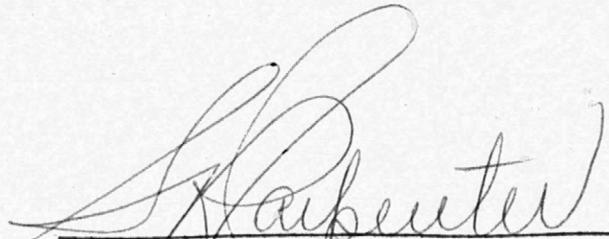
Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board the following matters relating to the Board's staff:

Transfer and employment on a regular basis

Transfer of Dorothy Drake from the position of Clerk to the position of Editorial Clerk in the Division of Research and Statistics, with no change in her basic salary at the rate of \$3,670 per annum, effective the date of assuming her new duties; and change in the status of Miss Drake's employment from a temporary basis until October 1, 1956, to a regular basis.

Extension of temporary appointment

Extension of the temporary appointment of Harold F. Golding, Clerk in the Division of Research and Statistics, from October 1 to October 19, 1956, with no change in his basic salary at the rate of \$4,075 per annum.


Secretary