Minutes for February 13, 1957

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		x
Gov. Szymczak	x	
Gov. Vardaman	x	
Gov. Mills	x	
Gov. Robertson	x	
Gov. Balderston	x	
Gov. Shepardson		x

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, February 13, 1957. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Vardaman
Mr. Mills
Mr. Robertson

Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Vest, General Counsel
Mr. Young, Director, Division of Research and Statistics
Mr. Sloan, Director, Division of Examinations
Mr. Masters, Associate Director, Division of Examinations
Mr. Shay, Assistant General Counsel

There was presented for consideration a draft of letter, which had been circulated to the members of the Board, to Mr. Braun, Assistant Secretary, Federal Reserve Bank of New York, reading as follows:

> Thank you for your letter of January 28, 1957, advising that in response to a request from Senator Walter J. Mahoney, Temporary President, The Senate, State of New York, the Board of Directors has extended for Mr. Thomas O. Waage, his leave of absence without pay until April 8, 1957, in order that he may continue to assist the New York State Joint Legislative Committee to Revise the Banking Law.
>
> The Board of Governors interposes no objection to the extension of leave for Mr. Waage, as described in your letter.

Approved unanimously.

Prior to this meeting there had been circulated to the members of the Board a draft of letter to Mr. Donald L. Rogers, Counsel to the

Committee on Banking and Currency of the United States Senate, reading as follows:

With your letter to Chairman Martin of January 22, 1957, you enclosed a letter of January 7, 1957, to Senator Robertson from Mr. Robert G. Hemingway, President of the Commercial Security Bank, Ogden, Utah.

Mr. Hemingway's letter refers to certain practices illustrated by the newspaper advertisement of "First Security" enclosed with his letter. The advertisement related that a rate of 3 per cent on savings would be paid by the First Security Bank of Utah, National Association, Ogden, Utah; the First Security Bank of Idaho, National Association, Boise, Idaho; and the First Security Bank of Rock Springs, Wyoming; while earnings at a 3-1/2 per cent rate would be distributed by the First Security Savings & Loan Association, Salt Lake City, Utah; and the First Security Savings & Loan Association, Pocatello, Idaho. These institutions are in the group headed by the First Security Corporation, Salt Lake City, Utah, a bank holding company.

In connection with this matter, Mr. Hemingway referred to the Bank Holding Company Act of 1956. Presumably, he has in mind section 4 of the Act which, with certain exceptions, prohibits a bank holding company after two years from the date of the Act from retaining ownership or control of any voting shares of any nonbanking company and from engaging in any nonbanking business. This prohibition, if otherwise applicable, would not take effect, however, until May 9, 1958. Whether or not this prohibition would then be applicable to this situation is a question which could be answered only on the basis of all the facts then existing with respect to the matter.

Section 4 of the Act, with certain exceptions, also prohibits a bank holding company after the date of the Act from acquiring ownership or control of any voting shares of any nonbanking company. The applicability of this prohibition also depends on the facts; but it would be violative of the statute for a bank holding company to acquire or to have acquired after May 9, 1956, voting shares of a company which is not a bank.

Also, it is to be noted that the prohibitions of section 4 referred to above are not applicable "to shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act". However, the Board has not been requested by the First Security Corporation to make any such determination.

Attention is invited to the fact that two of the banks in the First Security Corporation group are national banks and, therefore, are under the primary supervision of the Comptroller of the Currency. Moreover, the bank at Rock Springs, Wyoming, is not a member of the Federal Reserve System, but is understood to be insured by the Federal Deposit Insurance Corporation. Also, it appears from Mr. Hemingway's letter that some aspects of this matter have been previously brought to the attention of the Federal Savings and Loan Insurance Corporation.

It may be of interest in this connection to note that section 409 of Title VI of the January 7, 1957 Committee Print of Senator Robertson's Financial Institutions Bill would, among other things, make it unlawful for any company directly or indirectly to acquire the control of, or to acquire with power to vote more than 10 per cent of the stock of, more than one savings and loan association whose accounts are insured by the Federal Savings and Loan Insurance Corporation. Section 409 also seems designed to prevent insurance by the Federal Savings and Loan Insurance Corporation of a savings and loan association which is directly or indirectly controlled by, or more than 10 per cent of the stock of which is directly or indirectly held with power to vote by, any company which has the same relationship to another savings and loan association which is insured.

It is hoped that the foregoing may be of some assistance with respect to the matter discussed by Mr. Hemingway; and, as requested, Mr. Hemingway's letter to Senator Robertson, and its enclosures, are returned herewith.

Please do not hesitate to call upon us further if you feel that we may be of assistance.

Governor Robertson inquired whether it had not been the intention to say in the letter that an officer of First Security Corporation had assured representatives of the Board that the advertising practice referred to in the draft of letter would be stopped.

In response, Mr. Shay said that in an informal conversation the President of First Security Corporation indicated to him that arrangements regarding the advertising practice and certain other practices had been worked out which were satisfactory to the bank and savings and loan supervisory authorities primarily concerned. Mr. Vest added to these comments by saying that no reference to these statements had been included in the draft of letter because the conversation was of a general nature and the practices referred to in the letter were ones over which the Board had no jurisdiction.

There followed a discussion of whether, in the circumstances, the letter should include any mention of the statements made by the officer of First Security Corporation and it was decided, for the reasons given by Messrs. Vest and Shay, that it would be inadvisable to make any such reference in the letter.

At the instance of Governor Mills, there followed a discussion of provisions of the Bank Holding Company Act of 1956 pertinent to the inclusion of both banks and savings and loans associations in a holding company group. It was brought out, among other things, that at the present time there was no action for the Board to take unless First Security Corporation should apply for a determination pursuant to section 4(c)(6) of the Act. After May 1, 1958, two years from the date of enactment of

the Act, First Security Corporation might be found to be in violation of the law if it continued to control both banks and savings and loans associations, but this would be a matter within the province of the Department of Justice.

Governor Mills then suggested that it might be desirable to let First Security Corporation know that the advertising practice in question had been brought to the attention of the Board through a member of the Congress, and also concerning the nature of the Board's comments.

Accordingly, the suggestion was made that a letter be sent to First Security Corporation giving the substance of the Board's reply to Mr. Rogers.

In a further statement, Governor Mills said it was of some concern to him that while the Securities Exchange Act upheld the principle of divorcement between commercial banking and the underwriting of securities, existing law permitted relationships between commercial banking and another field of finance that could contain as many problems as the commingling of commercial banking and securities underwriting.

In connection with these comments by Governor Mills, reference was made to the provisions of the Bank Holding Company Act and Title VI of the proposed Financial Institutions Act of 1957, referred to in the draft of letter to Mr. Rogers, as offering the prospect that the present situation would be remedied.

Thereupon, the letter to Mr. Rogers was approved unanimously in the form set forth above, with the understanding that the substance of the Board's reply would be transmitted to First Security Corporation

in a separate letter and that copies of both letters would be sent to the Federal Reserve Bank of San Francisco.

Reference then was made to a draft of telegram to Mr. Diercks, Vice President of the Federal Reserve Bank of Chicago, which would authorize the Reserve Bank to make available to the United States Attorney for the Eastern District of Michigan information contained in examination reports of The City Bank and Trust Company, Jackson, Michigan, relating to a purported check-kiting operation, with the understanding that no information would be furnished from the confidential section of such reports. The telegram, copies of which had been sent to the members of the Board, would also state that the authorization was given with the understanding that the information would be used for the exclusive consideration of the United States Attorney's Office, only in developing leads in connection with the check-kiting operation, and not for any further purpose such as evidence in any proceeding.

At the suggestion of Governor Vardaman, it was agreed that there should be deleted from the telegram as a precautionary measure all reference to the member bank whose examination reports were concerned and to the specific United States District Attorney.

After Mr. Carpenter had stated that, with two additions to the wire which Mr. Vest would suggest, the proposed authorization would be in accord with the policy in dealing with requests of this kind

which was established by the Board in 1947, Mr. Vest suggested additions to the effect that no reference should be made to the source of information taken from the examination reports and that the reports should not be permitted to leave the offices of the Reserve Bank.

Thereupon, unanimous approval was given to a telegram to Vice President Diercks in the following form:

Board authorizes Federal Reserve Bank of Chicago to make available to the United States Attorney information contained in the examination reports of the Member Bank referred to in your letter of February 7 relating solely to the check kiting operation mentioned but not including any information in confidential section of such reports. This authorization is given with understanding that such information will be used for the exclusive consideration of the United States Attorney's Office and only in developing leads in connection with action regarding check kiting operation referred to in your letter, that no reference will be made to the source of the information, and that it is not proposed to use the information for any further purpose such as evidence in any proceeding. The examination report should not be permitted to leave the offices of your Bank.

Mr. Shay then withdrew from the meeting and Messrs. Cherry, Legislative Counsel, and Molony, Special Assistant to the Board, entered the room.

Pursuant to the understanding at the meeting on February 8, 1957, there had been sent to the members of the Board, with a memorandum from Mr. Vest dated February 11, a revised draft of proposed letter to The Honorable J. W. Fulbright, Chairman of the Senate Banking and Currency Committee, regarding bills S. 719 and S. 720, both relating to the provision of financing for small business. The revised draft took

into account the discussion at the meeting on February 8 and also the statement made by Chairman Martin before the Congressional Joint Economic Committee on February 5, 1957.

The principal discussion of the revised draft related to the portion thereof concerning the question of a possible deficiency in the facilities for providing short-term and intermediate credit for small business. After expressing doubt regarding any such deficiency, the draft would question the desirability of the enactment of S. 720, which would authorize the Small Business Administration to insure qualified lending institutions with respect to loans made to small business enterprises.

Governor Vardaman took the position that although existing facilities might be adequate, the proposed report on S. 720 emphasized this point unduly and did not make sufficient reference to the possibility of what he termed a maldistribution of loanable funds that was creating difficulty for some small business enterprises.

With regard to Governor Vardaman's comments, it was brought out that in a period of credit restraint certain marginal borrowers are bound to be disappointed, that there was no statistical evidence of widespread inability on the part of small businesses to obtain their share of available short-term and intermediate credit, and that the situation with respect to the marginal borrower was not apt to be eased simply by adding to the number of credit facilities.

It was agreed, however, that the draft should be modified in line with Governor Vardaman's suggestion so as to point out that in any system of credit a period of heavy demand for funds will result in some potential borrowers being unable to obtain access to credit.

Most of the remaining discussion centered around a paragraph of the draft which would cite the primary responsibilities of the Federal Reserve System and indicate that such functions would be hampered if the System should become involved in any extensive program for supervising new types of institutions engaged in the financing of business enterprise, as would be envisaged by S. 719. Certain changes in this paragraph in the interest of amplification and emphasis were agreed upon.

At the conclusion of the discussion, it was understood that Mr. Molony would revise the letter to incorporate the changes agreed upon at this meeting and it was understood that the letter would be sent in its revised form.

Secretary's Note: Pursuant to this action, the following letter was sent over the signature of Chairman Martin on February 19, 1957:

This is in response to your Committee's two letters of January 23, 1957, requesting the opinion of the Board with respect to the bills S. 719 and S. 720. Since both of these bills relate to the provision of financing for small business, they are being treated together.

S. 720 would authorize the Administrator of the Small Business Administration to insure qualified lending institutions with respect to loans made to small business enterprises up to an aggregate amount of $250,000,000, subject to increase by the President, after July 1, 1958, by an additional $500,000,000. The amount of insured loans to

any one borrower would be limited to $250,000; and the insurance could not exceed the lesser of 90 per cent of the unpaid balance of any loan or the amount of an "insurance reserve" to the credit of the lending institution. No insured loan could have a maturity of more than 5 years and 32 days.

S. 719 would provide for the formation of national investment companies, either by the Federal Reserve Banks or by groups of not less than five private persons, each such company to have a minimum capital of $5,000,000. The organization of such companies would be subject to the approval of the Board of Governors and their operations would be subject to regulation by the Board. The companies would be authorized to make loans to, and purchase common and preferred stock of, eligible business enterprises; and for this purpose each company would be authorized to borrow money by the issuance of bonds and other obligations up to the amount of its capital and surplus.

Basically, the Board believes that any proposals for Government action to provide additional credit facilities or mechanisms to business should be premised on a determination that there is an existing or prospective lack of such credit facilities on the part of small business enterprises not being furnished by commercial banks or other private lending institutions. In a period of restraint, some would-be borrowers who are unable to obtain credit may feel aggrieved and may actually be aggrieved. This, however, would seem unavoidable under any system of credit, once credit becomes scarce in relation to total demand. Apart from that matter, there is, on the basis of existing information, some question whether there is any deficiency in the economy's facilities and mechanisms for providing short-term and intermediate credit for small businesses. Consequently, the Board questions the desirability of the enactment of S. 720.

If there is any gap today in institutional or mechanical means for providing the necessary financing for business enterprises, it would appear to relate primarily to long-term debt and equity capital. For this reason, if consideration is to be given to legislation in this field at this time, the Board feels that it should be along the general lines of S. 719 providing for the organization of private national investment companies.

In the event favorable consideration should be given by the Congress to the enactment of any legislation of this kind, it is the considered opinion of the Board that responsibility for the supervision and regulation of such investment companies should not be lodged in the Board of Governors but rather should be vested in some other agency of the Government more primarily concerned with the problems involved in supervising capital financing.

The Federal Reserve System is charged by Congress with responsibility for influencing the total volume of money and credit available, with a view to fostering stable economic growth. However, it is not in a position to allocate loanable funds among different borrowers in the market, such allocation under our free enterprise system being the proper function of the commercial banks and other lending institutions.

The Federal Reserve System also is charged with responsibility for exercising supervision over its member banks, primarily with a view to fostering a sound banking structure. Any responsibility vested in the System over the operations of the proposed national investment companies could conceivably become inconsistent with the System's responsibility for supervising member banks who might, on occasion, hold the obligations of such companies. Nor can the matter be said to rest there. If the proposed investment companies are to fulfill constructively the desires indicated by this bill, it is clear that they will need to have intimate relationships with the commercial banking system: to have member banks buy their stocks, introduce customers in need of long-term equity financing, and service loans made by the investment companies. Under these circumstances, it would be sounder in the public interest if the chartering, supervision, and examination functions of the two types of institutions were entrusted to entirely different organs of the Federal Government.

If the organization and operation of national investment companies is not placed under the supervision of the Federal Reserve System, the Board would not object to legislation along the lines of S. 719, authorizing the establishment of such companies to provide long-term financing.

It is noted that S. 719 contains provisions which would repeal the present limited business loan authority of the Federal Reserve Banks under Section 13b of the Federal Reserve Act and provide for the payment to the Treasury of amounts totaling approximately $27,500,000 which have heretofore been paid to the Reserve Banks by the Treasury in connection with operations under that section. The authority of the Reserve Banks under this section was granted in the 1930's under

emergency conditions and has not been extensively used in recent years. In keeping with the views heretofore expressed as to the inappropriateness of the System participating in the financing of business enterprises, the Board would favor the repeal of this authority and the payment to the Treasury by the Reserve Banks of the amounts above mentioned, as provided in S. 719.

Mr. Carpenter reported receipt of a letter dated February 5, 1957, from the Comptroller of the Currency advising that he planned to issue a call this spring for reports of condition from all national banks and that he was so informing the President of the National Association of Supervisors of State Banks, with the request that all State bank supervisors likewise be informed. Mr. Carpenter stated that in accordance with the usual procedure, a telegram reading as follows was sent to the Presidents of all Federal Reserve Banks on February 11:

> Board contemplates making a spring call for condition reports on State member banks. You may so advise State Banking Departments for their confidential information. Understand Comptroller's Office will advise State Banking Departments of selected call date in usual manner before call is announced.

The action taken in sending the telegram was ratified by unanimous vote.

Governor Robertson said that at the end of 1956 the padding of deposits for statement purposes by member banks in the Eleventh Federal Reserve District was greater than ever before, amounting to about $600 million in the aggregate. He expressed the opinion that if this practice continued it could be the basis of public criticism affecting not only banks but the supervisory authorities. Consequently, he said, he intended to take the matter up with the Office of the Comptroller of the Currency.

He also had under consideration presenting to the Board a draft of letter to the five banks concerned, since he felt that the supervisory authorities must take a strong position. While the banks in the Eleventh District appeared to be the only ones substantially inflating their figures as to deposits, he noted that in the New York District banks borrowed heavily a few days before a call in order to show no borrowing on the call date.

The other members of the Board indicated agreement with the views expressed by Governor Robertson.

Governor Vardaman called attention to a practice he understood was being followed by banks in a chain banking system in the State of Florida which involved remitting by checks drawn on banks of the chain located in some other city, thus providing use of the funds represented by the checks for the delayed collection period. For example, it was his understanding that chain member banks were remitting to their customers with checks on Jacksonville and Miami banks. He expressed concern about the practice, but he did not know how widespread it might be or whether it was illegal in any way.

Following an explanation by Governor Mills of the procedures involved in practices of the kind referred to by Governor Vardaman, Governor Robertson suggested that it would be advisable for the Division of Examinations to ask the Federal Reserve Bank of Atlanta to provide a memorandum on the subject for the Board's further consideration.

There was unanimous agreement with this suggestion.

Governor Robertson reported that, pursuant to the understanding at the meeting of the Board yesterday afternoon, he called both the Comptroller of the Currency and the Chairman of the Federal Deposit Insurance Corporation to advise them of the request by the Senate Banking and Currency Committee (received following the Board meeting) for technical assistance from the Board's staff in connection with the Committee's work on the proposed Financial Institutions Act of 1957. He said that neither party raised any question although Chairman Cook of the Federal Deposit Insurance Corporation made the comment that that agency intended to restrict its activities in relation to the Committee's study to provisions of the proposed legislation affecting its own activities and that he assumed the Board would wish to follow a similar course.

The meeting then adjourned.

Secretary