To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council held on February 19, 1957.

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 WMM	
Gov. Szymczak	x	
Gov. Vardaman	x	
Gov. Mills	x	
Gov. Robertson	x R	
Gov. Balderston	x CCB	
Gov. Shepardson	x CCS	

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Tuesday, February 19, 1957, at 10:30 a.m.

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

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary

Messrs. Brace, Massie, Mitchell, Fleming, Kimball, Livingston, Miller, Baird, Kemper, Jacobs, and King, Members of the Federal Advisory Council from the First, Second, Third, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. James N. Land, Senior Vice President, Mellon National Bank and Trust Company, Pittsburgh, Pennsylvania

Mr. Prochnow and Mr. Korsvik, Secretary and Assistant Secretary of the Federal Advisory Council, respectively.

President Fleming reported that at its earlier separate meeting, the Federal Advisory Council elected Mr. Fleming as President of the Council, Mr. Denton as Vice President, and Mr. Prochnow and Mr. Korsvik as Secretary and Assistant Secretary, respectively. Messrs. Massie, Mitchell, and Livingston were elected directors to serve with Messrs. Fleming and Denton, ex officio, as members of the executive committee of the Council.

President Fleming stated that the Federal Advisory Council at its current meeting reaffirmed an earlier action to support the status of the Board of Governors of the Federal Reserve System as an independent agency of the Congress in the event any effort should develop along the lines of a suggestion made by Mr. Elliott Bell in the fall of 1956. The Chairman of the executive committee was authorized by the Council to use this action in whatever manner seemed appropriate.

Before this meeting the Council submitted to the Board of Governors a memorandum setting forth the Council's views on the subjects to be discussed with the Board at this joint meeting. The statement of the topics, the Council's views, and the discussion with respect to each of the subjects were as follows:

1. What are the views of the Council with respect to the business situation during the period from now until mid-1957? Among specific industries, the Board would like to have the Council's judgment as to the prospective demand for new model automobiles during this perood, as well as for used automobiles. Are further increases in prices of finished products expected? Is there any indication of a change in the supply-demand relationships that would call for a relaxation of credit restraints?

All members of the Council expect a high level of business from now until mid-1957. Although economic conditions may vary from district to district, it is anticipated that business generally will be good. However, the members of the Council are concerned with the continued narrowing of the profit margin, as this tends to make business investment progressively less attractive.

The Council believes it is somewhat early to make a definite prediction as to the demand for new model automobiles. Most districts expect that the number of new cars sold will be slightly higher in the first half of 1957 than in the corresponding period of 1956, but not as high as in 1955. The demand for used cars is good and should continue satisfactory for the first half of the year.

The prices of most finished products will probably increase, with certain exceptions such as appliances, textiles, and some chemical products.

The Council does not believe there are sufficient changes in the supply-demand relationships to call for a relaxation of credit restraints.

Chairman Martin stated that he would appreciate having the members of the Council comment on what he called the current "blitz of pessimism" regarding the economic situation, furnishing some assessment of the bases of such feelings and their significance.

Mr. Brace stated that the general feeling he had observed in New England was one of some disappointment in the outlook for the first half of 1957. He emphasized more strongly than was indicated by the Council's answer to this question the shrinking profit margins of business. New automobile sales had been disappointing and the outlook was somewhat gloomy. While this reflected weather conditions to some extent, there was also evidence that high prices were a factor in the reluctance of persons now having good automobiles to turn them in on new cars. Mr. Brace said the textile industry was not in good position and a number of mills had closed down recently, some of them permanently. On the other hand, shipbuilding was active and conditions in the machine tool industry were good, with profit margins being maintained. The important electronics industry was experiencing pressure, partly because it was difficult to know what profit margins would be on Government orders when deliveries were completed. One could find whatever condition he looked for among the large variety of small industries in New England, but the over-all view would not be one of pessimism yet, but of concern as to the outlook, with current business fairly active.

Mr. Massie said that business in the Second District for the fourth quarter of 1956 recorded quite a few all-time record highs, but within that framework there were some weak spots. The service industries were taking up any unemployment that developed in other spots. Personal income was at a new record level. The weak spots were the ones that had been weak in the past: employment in the textile industry was 20 percent below 1948 levels; and residential building was sharply below last year's level. Nonresidential private building (particularly commercial) was quite high, and public construction was 40 percent above a year ago. Automobile sales were reasonably good with the best records being shown by certain of the lower priced automobiles. Used automobiles were moving well. Over-all business could be characterized as being about as good as could be hoped for, Mr. Massie said, recognizing that at any given time some phases of business would be less good than others.

With respect to Chairman Martin's request, Mr. Massie said that he found some pessimism in the Second District - the largest amount turning up among persons principally interested in professional investing of money. These same people were not bearish on business in general but felt that prices of common stocks had risen so much over the past fifteen years that some adjustment was called for. This had a psychological effect on individuals. For example, there had been considerable shifting from good stocks to municipal securities. While he would not call this group bearish on the general outlook, Mr. Massie said that with present high employment and production levels it was difficult to find a stimulus that would carry activity to still higher levels.

Mr. Massie went on to describe a meeting of the Commerce Association of New York in November 1956 and a meeting he had with a small group of well-to-do individuals interested in real estate who expressed the view that the "tight money policy" was "killing off" building. They wished to have their views brought to the attention of the Board of Governors, Mr. Massie said, and he reviewed his discussion with these individuals who did not seem to understand how the monetary system worked. At the conclusion of the meeting, he said, they seemed to have a better understanding of the monetary policy being followed and the efforts being made to keep inflation down. It was Mr. Massie's view that the entire business community in the Second District was beginning to understand more about these matters.

Mr. Massie concluded his remarks with the statement that he felt business conditions currently were good but that he did not see how they could go forward immediately and, therefore, he anticipated some leveling off with further shrinking of profit margins.

Mr. Mitchell said that business in the Third District rose to a very high level toward the end of 1956 but that in the last month or so indications of leveling off had developed. This was healthy, he felt. Strong spots included the steel industry and metals in general, petroleum, and shipbuilding - the latter a new strong spot. The bituminous coal industry was moving along satisfactorily and the anthracite industry was showing some improvement for the first time since the war. The textile industry, which expected some pick-up three or four months ago, had shrunk back to a very low ebb. Residential building had dropped off in number of starts, but dollar volume approximated a year ago. Industrial and commercial building had held up well and public construction had increased. District department store sales were about at last year's dollar level, compared with an increase of about five percent nationally. New automobile sales were running about the same as a year ago and dealers' inventories were rather high pending what was expected to be better spring business. Inventories of goods generally were about in line with sales and businessmen were more cautious about increasing them than during 1956. Employment and wage payments were higher than a year ago, although hours of work were slightly lower. Money in the Third District continued tight.

Mr. Mitchell said that he expected business to stay on the current high plateau during the first half of 1957. Profit margins were shrinking and business confidence had weakened somewhat, particularly in the last month or so. This reflected developments in the stock market and the fact that capacity in most industries was adequate or in excess of current needs. Any slack resulting from falling off in private outlays during the next year would be taken up by increased Federal and local governmental expenditures. In sum, Mr. Mitchell believed that business was leveling off with a slight reduction in inflationary pressures, that this was a healthy development, and that any hesitation shown in the next few months would be a good thing if one looked to longer-run maintenance of better business over an extended period.

Mr. Land said that Fourth District business activity had continued at a high level since the Council's meeting last November. The steel industry continued to operate at a high rate although output had declined from 100 percent of capacity to a 97-98 percent rate, a development that had come a little sooner than the industry had expected. This might reflect the fact that in earlier months 10 to 15 percent of steel output had been going to inventory. By the end of March steel inventories would be back to the unduly high pre-strike level if present operating rates continued, and some further reduction in output might take place to prevent inventories rising further. The automobile industry had not been taking as much steel as was expected earlier, but the steel released by that industry had found ready takers in other lines. The glass industry had shown some slackening in activity, particularly in window glass output. The aluminum industry reflected a change in pace, compared with the very tight situation that had existed for some time, and aluminum producers were now hunting for buyers. Retail sales continued at a good level except for sales of appliances. Prices were tending to edge up, although certain fabricated aluminum items and window glass prices were tending to ease. Business confidence today was not as bullish as a few months ago, but Mr. Land did not feel the situation had worsened in recent weeks.

President Fleming said that developments in the stock market had had something to do with the feeling of pessimism that Chairman Martin referred to. The squeeze on profit margins was another factor. Press reports had over-emphasized the situation and had misinterpreted statements of the Secretary of the Treasury and others as to the business outlook.

As to the Fifth District, President Fleming said that over-all business continued good. Shipbuilding, coal production, and cigarette production were bright spots, and farm product prices were slightly better than earlier. Residential construction was down but industrial construction continued very strong. The furniture industry had weakened, and the textile industry was not in satisfactory condition. Despite these weak spots, President Fleming thought the over-all situation in the Fifth District should be described as good.

Mr. Kimball said that the long-term growth trend in the Atlanta District was continuing but that currently there was some concern about the future business outlook. Actual conditions were somewhat mixed, but among the favorable elements was the fact that personal income was continuing to grow at a faster rate than for the country as a whole. Consumers were spending their income at a higher rate than nationally, as indicated by department store sales and early active sales of 1957 model automobiles to fleet buyers. The automobile market now seemed to be weakening, however. As to unfavorable factors, Mr. Kimball said that cash receipts of farmers declined during 1956 and there had been some weakening in the paper and chemical industries. The textile industry, which had expected some improvement in late 1956, had been quite disappointing, and the lumber industry was still depressed. Bank loans had declined more than seasonally. Steel was becoming more readily available in the District. Developments in the stock market had had an effect in the Sixth District. Nevertheless, Mr. Kimball said that he believed business in the Sixth District would continue to grow although at a somewhat slower rate than in the past few years. With reference to Chairman Martin's request, he would describe the feeling in the Sixth District as being more in the nature of "uneasiness" than of "pessimism."

Mr. Livingston said that he did not find much pessimism among Seventh District businessmen. The level of the stock market inevitably had an affect on business confidence since many persons felt that it represented a composite of judgment as to the outlook. Currently, however, the Chicago District had a very high and satisfactory level of business. The farm implement business, which had been at a low level for several years, was now more hopeful than for some time. Agricultural income was up because of higher hog prices. On the other hand, the rise in hog prices had affected unfavorably the profits of meat packers. Retail sales were excellent at Christmas and still continued to be very satisfactory. Automobile sales had been somewhat encouraging. Mr. Livingston referred to the practice of discounting from list prices, stating that the discounts being allowed were not particularly significant indicators of the automobile market; they reflected the fact that dealers did not wish to accumulate too much inventory until they had a better feel of the market for this year's cars, and even more significantly, they reflected the fact that "fair-trade pricing" was disappearing as a merchandising element in the United States. Used car sales were excellent in the Seventh District. In summing up, Mr. Livingston said that business in the Seventh District was very good and would certainly continue to be good through mid-year. There was no general pessimism on the business front.

Mr. Miller said that the Eighth District was not unlike the rest of the country: business would be good during the first half of this year. Eighth District industry was fairly well diversified and not likely to be greatly affected by conditions in a single industry. He saw no evidence of capital expansion programs being abandoned, but plans for additional expansion were slowing somewhat.

On Chairman Martin's question, Mr. Miller said that in the Eighth District the business public was generally "cautiously optimistic". No undue accumulations of inventories had taken place except of appliances. Even there, General Electric Corporation was going ahead with plans for another production unit. Commercial construction was continuing at a high level and, while the number of housing starts was down, the dollar volume was holding up fairly well. The supply of small houses seemed to be reaching a saturation point and the demand was for somewhat larger houses. The Eighth District was not troubled with drouth conditions. Automobile sales were not as good as desired but were better than last year. Difficulties in marketing issues of bonds for public construction within the interest rate limitations set by States or local governments would delay some construction projects. All in all, Mr. Miller anticipated good business during the first half of this year.

Mr. Baird described conditions in the Ninth District as generally quite satisfactory, especially in the eastern part of the District. Employment in January was higher than a year ago. The farm machinery industry was showing some pick-up from the depressed conditions of a year earlier. Retail sales in January were about 2 percent higher than last year. Prospects for the iron ore industry for 1957 were very good, despite predictions of somewhat lower steel production later this year. Copper production had been reduced somewhat and paper manufacturing firms were experiencing a slight decline in sales.

As industrialization of the Ninth District progressed, agriculture carried less weight in the total, Mr. Baird said, but it was still the predominant activity. There was some indication of the drouth area being extended into western parts of the Ninth District and subsoil and surface moisture were not now sufficient to assure favorable growing conditions this spring. On the other hand, livestock producers had been favored by weather conditions to the extent that they had not had to feed hay heavily. Farm product prices were somewhat better than a year ago.

Mr. Baird commented on a symposium he attended a month ago at which he was surprised at the optimism shown by businessmen. Even the lumbermen were not too pessimistic. He pointed out, however, that studies showed that changes in Ninth District business lagged perhaps six months behind changes in the over-all national picture. Mr. Baird concluded his remarks with the statement that bank deposits had declined more than seasonally since the first of this year but were now picking up somewhat. Despite the loss of deposits, banks were not borrowing as much as a year ago.

Mr. Kemper said that the Tenth District was mildly optimistic regarding the period up to mid-1957. He had observed no pessimism, although there was uncertainty as to developments in the latter part of the year. The increased Federal budget and narrowed profit margins were factors causing uncertainty. In most industries output of goods was equal to demand, the cement industry being a possible exception. The stock market was a factor that had made people feel a little poorer.

Many people felt that we had a "give away Government."

While he personally was not pessimistic, Mr. Kemper said there was some reason for the feeling of uncertainty he had described. Within the Tenth District the situation was surprisingly good, considering that the worst of the drouth area was located in that District and there had been almost no relief thus far. Retail sales had held up fairly well although new automobiles could be bought at discounts as elsewhere and dealers were not making much money. Residential building was sharply below last year and this was being reflected in other businesses such as furniture and appliances. Public and corporate construction were up. Range conditions were poor, but soil bank payments were helping to increase farm income. The soil bank program in turn might affect the fertilizer business unfavorably.

Business loans of Tenth District banks had declined since the beginning of the year, Mr. Kemper said, and while an increase on the tax payment date could be expected, they would be a little lower by mid-year. Deposits were down about 10 percent since January 1, mostly in correspondent bank balances reflecting a move by those banks to purchase Treasury bills. Mr. Kemper said he would sum up the Tenth District situation with the statement that the area was getting along very well, considering the adverse conditions of nature.

Mr. Jacobs described business in the Eleventh District as flattening out at a high level. Department store sales were showing minor increases from the previous year. Non-farm employment had declined less than seasonally and recent rains, the best in two years, had helped greatly in the drouth areas, although more moisture was still needed. The oil industry continued at a very high level. Sales of new model automobiles in four larger cities of the District were about 4 percent better than a year ago but were 5 percent below December sales, and price resistance was evident with substantial discounts generally available on new cars. Residential building was running below last year, but public and industrial building was expanding. Sufficient mortgage money appeared to be available to take care of projected construction and, even with the decline in residential starts, Mr. Jacobs felt that total construction this year should equal or exceed that of 1956. Bank loans were higher than a year ago, but borrowings for tax purposes in March of this year would be lower than a year ago. In general, Mr. Jacobs felt that business for the first half of 1957 should be as good as in 1956 and perhaps better.

Mr. King referred to Chairman Martin's question by stating that in the Twelfth District optimism was on the high side relative to pessimism. The stock market seemed to cause less concern than in some other districts, although it was a factor. Mr. King suggested that at the present time the financial community and the press were inclined to select for news value the pessimistic segments of industry, rather than the items of a more optimistic type that had been evident for so long.

In the Twelfth District, employment continued at a very high level, Mr. King said, with three of the four principal cities in California listed as having "excess job opportunities." Residential building was running about 12 percent below a year ago, but other construction would bring the total up at least to 1956 levels. Sales of new houses slowed down last year but there had been considerable improvement in January and February of this year. The V.A. loans were practically "out of business" today and FHA mortgages were being sold at discounts. Mr. King expressed the belief that bank loans in the Twelfth District would increase from January to June this year by about 25 percent of the increase shown in the comparable period of 1956. Dealers in new automobiles were complaining that they were not getting deliveries of new cars rapidly enough. Some plans for plant expansion had been cancelled, but Mr. King said that he could select as many other plans that had been increased or expanded. Excess capacity at present seemed to be centered in the lumber, aluminum, and copper industries.

As a matter of interest, Mr. King noted that interest rates to be paid on savings deposits at Twelfth District banks had generally gone to 3 percent and that three-fourths of such accounts would now draw this interest rate, while an additional 17 percent would draw 2-1/2 percent. The increase in rate was probably reflected in a rise of $165 million in time deposits at District banks from January 1 to January 20 this year, compared with a decline of $24 million during the corresponding period a year ago.

Chairman Martin noted that this was the first meeting of the Council during 1957. He expressed appreciation for himself and on behalf of the other members of the Board for the careful, thoughtful consideration that the Council had given to the topics placed on the agenda and for the comments that had been presented. He emphasized the importance of these discussions in the work of the System, stating that one of the problems the Board faced constantly was the assessment of public attitudes. If the System was to be effective, it was necessary that it have the kind of back-stopping that had been given by Mr. Massie before the meeting of the New York Commerce Association; one of the members of that group had commented later that his entire attitude toward the work of the System and the function of monetary policy had been changed as a result of the meeting with Mr. Massie.

There was a tendency for the public to fear that the System operated in an ivory tower, Chairman Martin said, citing a recent discussion with a representative of a national magazine who said that he had been convinced the Federal Reserve operated in an ivory tower but that, after having assigned one of the magazine's representatives to observe the System, the attitude of the editors had been completely changed when they found that so many parts of the System participated in the reaching of decisions. Chairman Martin said that he was not suggesting that the operating structure of the System could not be improved, but he was suggesting that to preserve the things that were worth while in our country and economic and social system, it was essential to bring to bear the kind of thinking that was represented by the comments at this meeting with the Advisory Council.

The process used in presenting the comments of the members of the Council resembled the procedure followed at meetings of the Federal Open Market Committee, Chairman Martin said. He had become convinced that such a procedure was in no way a waste of time but that it gave perspective and balance and was of great help to the Board in trying to assess current tendencies. There were persons who questioned how effective a structure such as the System could be with seven Board members, the directors of the twelve Federal Reserve Banks and their branches, and the members of the Federal Advisory Council. There would always be honest differences of opinion and there might be better ways of conducting these meetings, but he had been encouraged by the way this procedure had developed. The Board depended on the Council and on the directors of the Federal Reserve Banks and their branches. He hoped that each member of the Council would put his shoulder to the wheel to see to it that the problem of a depreciated currency and the explanation of what was involved was presented to the public in a proper light. He mentioned a newspaper acquaintance who last spring felt that everything the System was doing was wrong but who, after having completed an extended tour of the country, now believed that the Federal Reserve was the bulwark of the currency, and he was considering writing a book about it. This change was not due to the Board but was because of the collective pulling together of different parts of the System. The Board welcomed having the members of the Council consider themselves as being on the firing line. It would be most helpful if, through their President or collectively or individually, they would bring to the attention of the Board any problems they felt should be discussed, including unpleasant problems.

President Fleming responded that he felt an improved atmosphere had developed between the Board and the Council over the years and that the Council had high regard for its working arrangements with the Board.

2. Do you know of revisions in business plans for plant and equipment expenditures in 1957? Are there evidences of excess productive capacity?

The members of the Council have been informed of downward revisions in plans for plant and equipment expenditures in some industries and of upward revisions in others. There is not at present sufficient evidence of downward revisions in business plans for plant and equipment in 1957 to change significantly total expenditures for these purposes.

There is evidence of excess plant capacity in certain lines. A large part of the expenditures for additional plant and equipment undoubtedly is an effort to increase operating efficiency and reduce costs in order to keep abreast in an increasingly competitive market.

There was no discussion of this topic.

3. What is the outlook for construction (residential, industrial and commercial, public) during the period from now until mid-1957? Do construction costs appear likely to be stable, to increase, or to decrease in the near future? Is mortgage money available in sufficient volume to support projected residential, commercial, and private construction during this period?

The Council believes housing starts in the first half of 1957 will be slightly lower than in the same period of 1956, but the dollar volume will be approximately the same because of larger housing units and higher labor costs. Industrial and commercial construction in the same period are expected to equal or moderately exceed their 1956 dollar volume, but public construction should be considerably above last year.

The total dollar volume of all construction from now until mid-1957 should be higher than in the corresponding period of 1956. Rising labor costs will be a major factor in increasing construction costs.

In reply to a similar question on the volume of mortgage money at the meeting in November, the Council stated:

> " . . . that mortgage loan demand was outrunning the supply of savings, that the rates of mortgages had risen, and that lenders had become more selective. . . . Less money is now available for mortgages, interest rates are higher and lenders are exercising greater selectivity.
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> "Rates on VA and FHA mortgages are now so unrealistic that this type of investment is becoming increasingly unattractive to lenders. Because of attractive rates, an increasing proportion of savings are being invested in corporate, state and municipal obligations rather than in mortgages."

Since the Council's statement, higher mortgage interest rates and the decline in housing starts have tended to bring about a better balance in the supply of funds available for conventional mortgages.

Except for the VA mortgages whose present fixed rates are unattractive, sufficient mortgage funds are expected to be available to finance the anticipated volume of construction from now until mid-1957.

There was no discussion of this topic.

4. What are the probable changes in volume of bank loans during the first half of this year? Is the volume of borrowing for tax purposes in March likely to equal or exceed that of a year ago? What is the outlook for consumer credit?

The members of the Council expect the volume of bank loans to increase moderately between now and the end of June.

Some districts experience little or no borrowing for tax purposes, but **most** districts in which there is a concentration of large corporation accounts expect that the volume of borrowing for tax purposes in March may exceed that of a year ago. This will result in an increase in such loans for the System as a whole.

The volume of consumer credit may be expected to increase moderately in the first half of the year.

President Fleming said that in preparing the Council's statement on this topic, it had been assumed that the Board was interested in views as to the outlook for bank loans from mid-February until the middle of the year. He also referred to the presentation made to the Council by Mr. Thomas, Economic Adviser to the Board, yesterday afternoon, adding that on the basis of that presentation he felt more certain that the expectations indicated in the Council's statement would be borne out.

5. What, if any, changes would the members of the Council suggest in the System's current credit policies between now and mid-year?

The Council believes, as stated in its Memorandum to the Board in November,

> " . . . that the System's credit policies have been appropriate and well executed, especially in view of the difficulties which are always present in evaluating economic trends. Assuming a continuance of present economic conditions, the Council suggests that current credit policies be maintained with the same degree of restraint . . . " for the period between now and mid-1957.

President Fleming noted the absence in the above statement of any suggestion that the discount window at the Federal Reserve Banks be kept open. This was partly because the tendencies that had developed last April for some bankers to feel that the discount facilities might not be adequately available had disappeared and everybody now anticipated that the discount window would be kept open for legitimate purposes.

President Fleming went on to say that the Council felt that credit policy had been well executed, that it realized the difficult day-to-day problems that were presented in this field, and that it had no suggestions for change at this time in the general policy now being followed.

6. Do the members of the Federal Advisory Council have observations as to any features of the Bank Holding Company Act or its operation to date which they feel would be of assistance to the Board in administering its responsibilities under the law?

The members of the Council who have had experience with holding companies will present their views orally to the Board on this item of the agenda.

President Fleming said that all members of the Federal Advisory Council were interested in the over-all operation of the holding company legislation but that only a few had been directly concerned with the techniques of its administration. Messrs. Baird, King, and Kimball would comment at this meeting on certain aspects of the law, and the Council would be glad to have the topic on the agenda for the meeting to be held in May with the thought that between now and then the members would study the matter and come prepared to discuss it more fully. He then called upon Mr. Baird who presented four matters relating to the holding company legislation as described below.

1. Mr. Baird questioned the need for or desirability of the prohibition in the Bank Holding Company Act of 1956 against "horizontal loans," i.e., loans made by one holding company bank to another bank in the same system. He noted that "upstream" loans within a holding company system were

precluded under previous legislation, and he agreed that they should be. However, he felt that a holding company bank should not have to discriminate against an affiliated correspondent bank, stating that he believed a holding company bank should discharge its obligations to an affiliated correspondent in the same manner that it would to one that was not affiliated. It was Mr. Baird's belief that any abuses could be fully covered by requiring that Government securities be pledged at par or market value against such advances.

2. The second technical point, Mr. Baird said, was the provision in the Bank Holding Company Act of 1956 that prevented banks controlled by a holding company from making loans secured by the stock of the holding company. He had no quarrel with this provision but felt that it was obscure as between prohibitions against new loans and renewals of old loans. He hoped the Board might rule that an existing loan might be renewed but not increased. He noted that in the course of time such loans would disappear.

3. Mr. Baird then referred to Senate Bill 1075 which would extend further the exemption under the Bank Holding Company Act of 1956 for religious, educational, or charitable institutions by making it apply to wholly owned subsidiaries of such institutions. It was Mr. Baird's opinion that if any action were to be taken on the subject of exemptions, they should be limited rather than increased. He felt that holding companies owned by educational and charitable institutions presented the same problems from the standpoint of the need for regulation as did other holding companies, noting that their methods of operation and the competitive factors were the same regardless of ownership. In principle, he felt that this would apply to religious institutions although he recognized the political difficulty of eliminating that exemption. However, he felt particularly that exemptions of charitable and educational institutions and their subsidiaries should be restricted rather than extended.

Governor Robertson asked the question whether, if the Congress still provided exemption to religious, educational, and charitable institutions, there was good reason why the same exemption should not be extended to wholly owned subsidiaries of the parent institution. To this, Mr. Baird indicated that he felt the same reasoning would apply to the parent and subsidiary institutions.

4. At Mr. Baird's request, Mr. King presented a suggestion made by the Federal Reserve Bank of San Francisco that the Board seek legislative reconsideration of the "other than a bank" clause of section 3(a)(3) of the Bank Holding Company Act of 1956. Mr. King stated that he was presenting this not as a suggestion of his own but as a communication that the Reserve Bank had submitted to him. The Reserve Bank felt that by allowing bank subsidiaries of bank holding companies to merge through the asset acquisition route, an inexplicable distinction between stock and asset acquisition, such as existed under section 7 of the Clayton Act, was perpetuated. The Bank also felt that the exemption given to bank asset acquisition mergers flouted the spirit if not the letter of section 3(d), the so-called Douglas amendment.

Mr. Baird stated that while he had just heard of this proposal, it apparently would add a requirement that, in addition to approval by the State authorities if a State bank or the Comptroller of the Currency if a national bank, the Board give its consent before a bank holding company bank acquired the assets of, or merged with, any other bank. In a State other than the home State of the holding company, the proposal also would prohibit an acquisition or merger by a bank holding company bank with another bank unless the statutes of that State expressly authorized such action with respect to out-of-State bank holding companies. Mr. Baird stated that such a requirement would be discriminatory against a bank holding company bank and that it would be unjustified. He also pointed out that at the present time mergers involving national banks required the consent of the Comptroller of the Currency, and those involving only State banks required the approval of the State supervisory authority. After stating in some detail his reasons for opposing legislation such as the San Francisco Bank proposed, Mr. Baird expressed the hope that the Board would not support the legislative suggestion of the San Francisco Bank.

Mr. Baird stated that he would have his comments on the third and fourth points prepared in memorandum form and distributed to the Board and the Council.

> Secretary's Note: The memoranda referred to were submitted by Mr. J. H. Colman, President, First Bank Stock Corporation, under date of February 22, 1957, and copies are attached to these minutes as Items 1 and 2.

President Fleming then called upon Mr. Kimball, who stated that he wished to report tendencies or developments taking place in the Sixth District in connection with the exemption from the definition of a bank holding company under section 2(a)(3)(e) of a company if at least 80 per cent of the total assets were composed of holdings in the field of agriculture. This exemption was being used by so-called "agricultural" organizations as a means of acquiring banks at very high prices and was causing apprehension among banks as well as others. The purchasing organization could afford to pay excessively high prices for such banks because of its ability to offset the excess payments through depreciation on cattle and citrus assets under the tax provisions. Because of the high prices some of these "agricultural" organizations were thus able to pay for banks, there was concern as to how far pyramiding of control of banks might go outside the regulation.

In the discussion that followed, Chairman Martin suggested that the topics relating to the Bank Holding Company Act of 1956 be kept on the agenda for meetings of the Federal Advisory Council throughout the two-year period from date of enactment of the law, within which period the Board was to submit to the Congress recommendations for changes in the legislation, pursuant to section 5(d) of the Act.

Governor Robertson stated that he would like to have the views of the Council as to whether the Board would be justified in recommending that there be eliminated from the Bank Holding Company Act all special exemptions from the definition of a bank holding company.

President Fleming responded that the topic would be kept on the agenda and that the members of the Council would study the subject with a view to discussing it at later meetings. Specifically, he suggested that all members of the Council examine the exemptions from the definitions of a bank holding company provided in the law, to which Governor Robertson had referred, with a view to discussing them at the next meeting of the Council and the Board. He also suggested that in the meantime the Council members send their written comments directly to the Board.

Governor Vardaman stated that he thought another subject that should be considered was the practice followed by certain chain banking groups of publishing combined figures of condition for all banks in the group.

Governor Robertson then stated that he would like to have the Council give some thought to a problem that had been giving difficulty to the bank supervisory agencies for some little time, namely a process whereby certain banks, relatively few in number, carried on extensive "window dressing" operations for the purpose of inflating deposits and reducing figures of bank borrowing at times of the regular reports of condition. He stated that in one district the padding of deposit figures resulted in overstating deposits by approximately $600 million in the report of condition at the end of December 1956. He hoped that the Council would study the problem and at a future meeting discuss ways in which the practice might be eliminated.

President Fleming stated that the Council would be glad to discuss this subject at the next meeting.

Governor Shepardson referred to Mr. Kemper's remarks and inquired whether requests for advances against soil bank certificates were presenting a problem for banks.

Mr. Kemper said that this had not yet become a problem in the Tenth District. However, he felt it might present difficulty if the smaller banks came to their city correspondents for substantial assistance in making such advances, even though the present soil bank contracts precluded a reassignment of the certificates.

President Fleming stated that the next meeting of the Council was scheduled for May 19-21, 1957, but that if the Board had no objection the members of the Council would prefer to meet on Sunday, May 12, with the understanding that the joint meeting of the Council with the Board would be held on Tuesday, May 14, 1957.

Chairman Martin stated that this would be satisfactory to the Board, and it was understood that the meeting would be so scheduled.

Thereupon the meeting adjourned.

Secretary

Memorandum

Re S. 1075

A bill has been introduced in the Senate - S. 1075. We are informed that this was done at the instance of a registered bank holding company domiciled in Minnesota and owning an interest in some 30 banks situated in a number of states. The holding company in question is owned by a charitable foundation.

The bill would amend the Bank Holding Company Act of 1956 by eliminating from the definition of a bank holding company (and therefore from all provisions of the Act) any corporation wholly owned by a religious, educational or charitable institution.

It is true that, as the statute now stands, a religious, educational or charitable institution directly owning the stock of several banks is exempted under the definition of a bank holding company. The proposal would extend this exemption to a wholly owned subsidiary of such an institution.

It is suggested that, if any action is to be taken on the subject of exemptions, they should be limited rather than increased. The present exemptions under Section 2(b) of the Act are based upon the use to which dividends paid by the banks are to be put - religious, educational or charitable purposes. This leaves untouched the real objects of the Act: first, to regulate expansion of bank holding companies in the public interest and second, to divorce banking from other business operations. These objects are present whether the bank holding company is owned by individual investors or by a charitable foundation or other exempt institution. The method of operation is the same regardless of the ownership.

The bank holding companies proposed to be exempted may well be in competition with non-bank holding companies, and their banks are certainly in direct competition with other banks. The same need for regulation of such bank holding company exists as with respect to investor-owned bank holding companies.

Regulation of religious bodies by administrative agencies is probably undesirable and perhaps the religious exemption should be retained. We know of only one instance where such exemption is applicable. But exemption of charitable and educational institutions with subsidiaries competing directly with nonexempt organizations is indefensible, in our opinion. Equally undesirable is the exemption of a bank holding company where 80 per cent of its assets are in the field of agriculture. The Act gives a very broad definition of the word "agriculture". This exemption would permit, for example, a large lumber manufacturer to combine such operations with the operation of a group of banks, so long as the net worth of the banks was not more than one-quarter of the value of the lumber interests.

This subject of exemptions should not be handled piecemeal but could well be treated in the report which Section 5 of the Act requires the Board to make to Congress within two years from May 9, 1956.

We would hope that the Board's recommendations to Congress would be in the direction of striving to eliminate all exemptions from the Act. It is in the public interest that all bank holding companies should be treated equally with respect to (1) the requirement of obtaining approval for additional stock acquisitions, (2) the requirement of divesting themselves of nonbanking activities, and (3) the requirement of accumulating statutory reserves of liquid assets under the provisions of the Banking Act of 1933.

Respectfully submitted,

First Bank Stock Corporation

(signed) J. H. Colman
J. H. Colman
President

February 22, 1957.

Memorandum
on
Suggestion of Federal Reserve Bank of San Francisco
for Amending Bank Holding Company Act of 1956

We understand that this suggestion was made in the following language:

> "It is suggested that it might be advisable for the Board to seek legislative reconsideration of the 'other than a bank' clause of Section 3(a). It would seem that by thus allowing bank subsidiaries of bank holding companies to merge through the asset acquisition route, an inexplicable distinction between stock and asset acquisition, such as exists under Section 7 of the Clayton Act, is perpetuated. The exemption given to bank asset acquisition mergers seems to flout the spirit if not the letter of Section 3(d), the so-called Douglas Amendment".

As the law now stands, all subsidiary banks of a bank holding company (whether the subsidiary bank is situated in the home state of the bank holding company or in another state) may acquire the assets of another bank in the same state on precisely the same terms as apply to any other bank in the same state. Statutory merger or consolidation is, of course, one method of acquiring the assets of another bank and, under present law, bank holding company banks, wherever situated, may merge under the same circumstances as can unit banks.

The proposal apparently would change this situation in two respects:

1. Prior approval of the Federal Reserve Board would be required if the bank holding company bank situated in the home state acquires the assets of, or merges with, another bank in such state. No such Federal Reserve Board prior approval is required of such action by a unit bank.

2. A bank holding company bank situated in a state other than the home state of its bank holding company would be absolutely prohibited from acquiring the assets of, or merging with, another bank in such second state unless the statutes of such second state expressly authorize such action with respect to out-of-state bank holding companies. No such statute exists in any of the 48 states and the possibility of enactment of such a law lies in the future. The present effect of the proposal, therefore, is an absolute prohibition of the right of a bank holding company bank in such second state to merge with, or acquire the assets of, another bank in such state, although its unit bank competitor across the street is permitted to merge with another bank or acquire its assets.

No reason is advanced for this discrimination against a bank holding company bank. The subject of the Clayton Act and its distinction between acquisition of assets and acquisition of stock is wholly beside the point.

Under the proposal only bank holding company banks (1) would be required to procure prior approval from the Federal Reserve Board for such action in the bank holding company's home state and (2) would be absolutely prohibited from such action in a second state. All other banks would continue to have the right to merge or acquire another bank's assets without approval of the Federal Reserve Board. If the Clayton Act is to be changed to apply to bank mergers and to the acquisition by one bank of the assets of another, then such legislation should apply to all banks and not merely to the small minority of bank holding company banks. No public policy warrants any discrimination in this respect between bank holding company banks and other banks.

The policy of the Bank Holding Company Act of 1956 was to regulate bank holding companies, not to regulate banks except to the extent necessary to prevent upstream loans or loans to affiliates or upon the security of stock or obligations of affiliates. The contributions made by bank holding companies to the country's economy were recognized in the hearings resulting in the 1956 legislation. The intention of the Act was to regulate bank holding companies (1) in their expansion by acquisition of stock of additional banks, and (2) by requiring divestment of nonbanking assets. The policy of the Act certainly was not to discourage growth on the part of holding company banks nor to penalize their activities.

A merger of two banks always requires the consent of the Comptroller when a national bank is involved, or of the state supervisory authority if only state banks are involved. The proposal would merely add the requirement of a second regulatory permission where the banks are situated in the home state of the bank holding company. It would completely prohibit such action in other states.

Acquisition of the assets of another bank does not by itself add another banking office to the acquiring bank, even where branch banking is permitted. Such additional office requires regulatory permission of the Comptroller or of the state supervisory authority. The proposal adds a second set of required regulatory permissions, at least where a branch is to result. It absolutely forbids such asset acquisition in a second state.

The proposal would deprive a bank holding company of a most important right possessed by all other banks. It would restrict competition by permitting, for example, a large unit bank to merge with, or acquire the assets of, another bank while prohibiting (in a state other than the home state) a smaller bank holding company bank from growth by merger with or acquisition of the assets of another bank.

Minority stockholders in a holding company bank - who are innocent bystanders - will suffer, since their bank will not be permitted to merge with another or buy another bank's assets, while the competing bank may do so.

The proposal would prevent, in a state other than the home state of the bank holding company, two banks from merging even though a bank holding company owns the stock of both banks.

Bank holding company legislation should regulate bank holding companies - it should not regulate banks in matters not pertaining to holding companies. It should not restrict growth on the part of holding company banks by any restrictions not equally applying to unit banks. No public policy is served by prohibiting a bank holding company bank from merging with or from acquiring the assets of another bank, if such action is in the public interest. Frequently a merger may increase competition by creating a bank more competitively equal to an existing competitor bank. Frequently also, merger or acquisition of the assets of another bank is desirable where such other bank is in unsound financial condition.

The proposal would mean that, if a particular merger or bank take-over were desirable from every point of view, it nevertheless could not be consummated if one of the banks was a subsidiary of a bank holding company of another state.

The proposal would put a wholly unnecessary stumbling-block in the way of the orderly growth of the national banking system. It would prohibit a national bank owned by a bank holding company domiciled in another state from growing by merger or by a bank takeover, whereas competing banks would be permitted to take such action.

Bank mergers and bank takeovers should stand or fall on their own feet and be permitted or denied according to the individual circumstances. They should not be prohibited in advance on a wholesale scale - they should be regulated in the public interest.

We would hope that the Board of Governors of the Federal Reserve System will not lend encouragement to this proposal.

Respectfully submitted,

First Bank Stock Corporation

(signed) J. H. Colman
J. H. Colman
President

February 22, 1957.