

Minutes for February 6, 1959


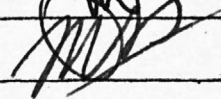
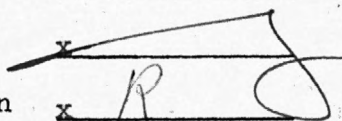
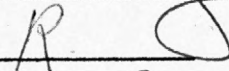
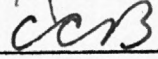

To: Members of the Board

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. Mills	x 	_____
Gov. Robertson	x 	_____
Gov. Balderston	x 	_____
Gov. Shepardson	x 	_____

Minutes of the Board of Governors of the Federal Reserve System  
on Friday, February 6, 1959. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. Solomon, Assistant General Counsel  
Mr. Nelson, Assistant Director, Division  
of Examinations  
Mr. Hill, Assistant to the Secretary

Discount rates. Unanimous approval was given to telegrams to the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, Chicago, St. Louis, and Dallas approving the establishment without change by those Banks on February 5, 1959, of the rates on discounts and advances in their existing schedules.

Application to organize a national bank at Des Moines, Iowa  
(Item No. 1). The Comptroller of the Currency had requested a recommendation as to whether a pending application to establish a national bank in the Merle Hay Plaza Shopping Center, Des Moines, Iowa, should be approved. Following an investigation, the Federal Reserve Bank of Chicago suggested an unfavorable recommendation, principally because the State banking authorities had approved an application to organize a bank in the shopping center which had priority over that of the proposed national bank and there appeared to be no need at this time for more than one bank. The Board's Division of Examinations had submitted a draft of letter to the

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Comptroller reflecting the findings of the Chicago Reserve Bank, and the file had been circulated to the members of the Board.

Following a discussion of the facts involved, the letter to the Comptroller of the Currency, a copy of which is attached as Item No. 1, was approved unanimously.

Branch application of City Bank (Item No. 2). There had been circulated to the members of the Board a file concerning an application by the City Bank, Detroit, Michigan, to establish a branch at Ann Arbor Trail and Evergreen Road in Wayne County. The Federal Reserve Bank of Chicago recommended disapproval on the basis of the applicant bank's inadequate capitalization, and the Division of Examinations had submitted a draft of a proposed letter to City Bank which would indicate that approval of the application could not be justified because the bank's present capital structure was believed to be inadequate in relation to the volume of its business and insufficient to support the proposed expansion. The letter would express willingness, however, to reconsider the application when provision was made for a satisfactory capital structure of the bank.

Governor Mills said that he found this a very difficult case. After noting that the Board on September 25, 1958, had denied an application by City Bank for a branch at another location for the same reason, namely, inadequacy of capital structure, and that such application

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later was withdrawn, he commented that the bank had ignored the Board's reasoning that its capital was inadequate to support expansion, which would argue logically for denial of the present application. However, he had dissented from the earlier decision, and he could find a justification in his own reasoning to approve the present application, which represented in effect a substitution. In this connection, he referred to City Bank's good management and asset condition. To judge from the growth of the bank's deposits, he said, it was performing a useful function in a community that deserved to have as many competing banks as could reasonably and conservatively operate. Without question, the bank was seriously short of capital on the basis of any formula that might be applied, although some allowance might be made for the fact that a bank with clean assets was entitled to more liberal consideration in appraising its capital requirements than a bank with possibly a higher capital ratio but an inferior quality of assets. Earnings of City Bank in recent years had been running around \$350,000, or possibly as high as \$400,000, a year, so that on the basis of retention of earnings, and assuming that the level of earnings would be maintained, the capital would appear to be sufficient to protect the additional liabilities in prospect through establishment of the proposed branch. By establishing the branch, the bank would of course be adding to the backlog of capital that would be necessary to make up its obvious deficiency at the present time.

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Considering the Board's action on the bank's previous branch application, Governor Mills recognized that it might seem illogical to grant the current application. However, his personal reasoning would favor approval, with a letter to City Bank stating that it would be unreasonable to expect favorable consideration of further branch applications until the bank on its own initiative took steps to correct the capital deficit that had been repeatedly brought to its attention by the Federal Reserve System.

Governor Balderston stated that he too had been concerned about this matter for reasons similar to those expressed by Governor Mills. He recalled having raised a question when the previous branch application was under consideration as to how a struggling bank, with inadequate capital but good management, could improve its position if it were denied the opportunity to compete in areas where additional business could be secured; that is, to shift to new geographical areas where the obtaining of additional business would be facilitated.

Governor Shepardson said that, if he understood Governor Balderston's thought correctly, it was that expansion into another area might permit a bank's earnings to grow sufficiently to offset both the increased need for capital and the already existing capital deficit. In the case of City Bank, he understood that retained earnings might be sufficient to offset the need for capital incident to further expansion of business but that they would not eat into the existing backlog of capital deficiency.

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Governor Balderston responded that for some time, perhaps a matter of years after the new branch was established, there admittedly would be a drain on the institution. Ultimately, however, he would suppose that the new branch, if well located, would help City Bank to build up its capital. If the bank were to establish too many branches too fast, it obviously would get into a risky situation that the Board could not permit, and such a line of argument would favor denial of the branch application. On the other hand, if the Board were to deny any new branches, it seemed questionable whether the bank would have the healthy growth that would aid it in building up its capital from retained earnings. In this case, he had concluded that the arguments resolved themselves in favor of denying the application but he would like to see the System encourage the expansion of well-managed banks, even though at the time they did not happen to be entirely free of financial problems.

Governor Robertson said that he too had an emotional reaction in this case because he knew of the good job that the management had done in correcting difficulties confronting the institution and he would like to see the bank be able to expand. However, he did not think that that was the wise course. As he saw it, the Board should not permit a definitely undercapitalized bank to expand branchwise, when the purpose of the expansion was to grow larger, any more than it should permit a bank to go into business without any capital on the theory that eventually it would earn enough to protect the depositors. If he could see some way

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to justify expansion in the case of the City Bank, he would favor approval of the application, but he could not find any such justification. If the Board were to approve this application simply on the basis that the management of the bank had worked hard to improve the institution, while at the same time it knew that the management did not want to add more capital because of a fear of diluting its control of the bank, the Board would find itself in a difficult position to deal with other institutions that had presented the same problem in the not too distant past. In other words, a very unfortunate precedent would have been established. In summary, he did not see how the Board could adhere to the principle of being absolutely impartial and objective without supporting the negative recommendation of the Federal Reserve Bank of Chicago.

In further comments, Governor Robertson suggested that the letter to City Bank include recognition of what had been done by the present management in correcting conditions within the institution. Such a letter might then go on to say that although the Board could not find its way clear to approve the branch application at this time in view of the inadequate capitalization of the bank, it would be glad to reconsider the matter at such time as provision was made for a satisfactory capital structure.

Governor Mills then stated that he would like to record his vote for approval on the grounds he had stated. He wished particularly to emphasize the fact that the Board was considering an application for

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a single branch and not a trend. As he had said, it would be his view that approval of this branch, if that were the decision, should be coupled with a denial of any further opportunities for expansion until the capital position of the bank had been corrected.

Governor Mills went on to say that perhaps there was a philosophical position that the Federal Reserve System, as a bank supervisory authority, might want to indicate to member banks; namely, that a bank is a public service institution and has a responsibility to defend and protect the public interest, and that when its growth reaches a point where the management is no longer able to introduce its own share of new capital the bank must cut its ties and become a publicly-owned institution. That, he said, had been the history of most of the larger banks throughout the country. Generally speaking, the larger a bank had grown the smaller in proportion had become the interest of the original shareholders and the greater the proportion of capital represented by public distribution of the bank's shares.

Mr. Nelson then discussed the reasons for the reluctance of City Bank's management to sell additional stock, the recent continued growth of the bank's deposits, the further growth that would be in prospect through establishment of the new branch, the efforts of the Federal Reserve Bank of Chicago over a period of time to persuade the bank to introduce additional capital, and the reported concurrence of the State banking authorities in the view that more capital was needed. The State authorities,



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he noted, had demanded more capital when the current application was presented and had withdrawn that demand only when it was argued that the application was in substitution for the previous application which the State had approved. In these circumstances, the Division of Examinations did not feel that it could recommend approval of the branch.

Thereupon, it was agreed, Governor Mills dissenting, to deny the branch application of City Bank, with the understanding that the letter to the bank would be phrased along the lines Governor Robertson had suggested. A copy of the letter sent to City Bank through the Federal Reserve Bank of Chicago pursuant to this action is attached as Item No. 2.

Branch application of Hadley Falls Trust Company (Items 3 and 4).

Through the Federal Reserve Bank of Boston, Hadley Falls Trust Company, Holyoke, Massachusetts, had requested the Board to approve the establishment of a branch in the Fairview section of Chicopee, Massachusetts. The Federal Reserve Bank recommended favorably, as did the Board's Division of Examinations. However, the proposed letter to the member bank, which had been circulated to the members of the Board, would state that the bank's capital structure was not considered satisfactory and that establishment of the branch was being approved only in view of the minimum of expansion involved and the convenience it would afford present customers. The letter would further state that the Board wished to impress upon the bank the need for strengthening its capital structure as rapidly as possible.

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Likewise, the proposed transmittal letter to the Federal Reserve Bank of Boston would note the continued undercapitalized position of Hadley Falls Trust Company and would state that, after giving due consideration to the bank's substantial holdings of State, county, and municipal obligations and other favorable factors, it would appear that a minimum of \$500,000 of new capital funds would be required to bring the capital structure into an acceptable position. In view of normal growth expectations, it did not appear that retention of earnings alone could be relied upon to cure the deficiency, which indicated that the bank was faced with the alternative of selling additional capital or of substantially reducing its volume of loans and/or other risk assets. The letter would further state that the Board would not be inclined to give favorable consideration to further expansion branchwise until and unless capital funds and risk assets were brought into a more acceptable relationship and that the Reserve Bank's efforts to bring about a strengthening of the capital structure should be vigorously pursued.

Governor Robertson said that he was unable to draw a distinction between this case and the application of the City Bank just denied by the Board. As between the two cases, he would in fact be inclined to grant the branch requested by City Bank and deny the application of Hadley Falls Trust Company. Recalling the long history of efforts of the Board and the Federal Reserve Bank of Boston to induce the Holyoke bank to improve its capital position, he noted that the bank had resisted such efforts and at times had indicated that it might withdraw from System membership.

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As to the contention of the applicant bank that the establishment of the proposed bank would not represent expansion but rather an attempt to give better service to present customers, he said that this argument was often made in applications of this kind but never appealed to him. As he saw it, the management of the applicant bank was simply trying to build up the institution. While the present management had done a good job in working out of a difficult situation, he felt the Board could not take the position in any section of the country that an undercapitalized bank was going to be permitted to expand its business. Accordingly, he would favor turning down this application, with advice to the applicant bank that when it was in a properly and adequately capitalized position the Board would be glad to reconsider the matter.

In response to a question by Governor Balderston, Mr. Nelson reviewed the extent of capital deficiency, as indicated by the form for analyzing bank capital, and suggested that the considerable volume of holdings of high-grade municipal securities might constitute something of an offsetting factor. He also reviewed the revision of capital structure last year whereby the bank retired its outstanding preferred stock and sold \$150,000 of additional common stock. While the bank had been forced to increase the rate of interest paid on time deposits to 3 per cent, it had agreed to restrict the payment of dividends and anticipated adding about \$100,000 a year to its capital structure through retention of earnings.

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Mr. Nelson then described the location of the proposed branch as being just outside an Air Force base where the bank was already operating a facility and referred to the contention of the bank that the proposed branch was intended principally to expand the services now offered to users of the facility. The Reserve Bank, he said, did not feel that establishment of the branch would lead to any material expansion of the bank's deposits, particularly since a competing national bank had recently established a branch only about two miles from the proposed site. He added that the Hadley Falls Trust Company was very conscious of the expansion of Springfield banks into its area and wished to maintain its own position as well as possible. Referring to a recent conversation with First Vice President Latham of the Boston Reserve Bank, he said Mr. Latham felt definitely that the bank needed to strengthen its capital position. On the other hand, Mr. Latham believed that the present management was doing a good job and he was strongly of the opinion that the bank should be given the right to protect its business in the Chicopee area.

Mr. Nelson acknowledged that it was very difficult to distinguish between this case and that of the City Bank since both banks were undercapitalized to about the same extent percentagewise. However, the Division of Examinations had differentiated between the two cases on the basis that this branch application did not contemplate any

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substantial expansion of business while in the other case the applicant bank was definitely expanding and hoped to gain more business through establishment of the new branch.

Mr. Solomon commented that these two cases offered a good example of a situation where judgment must enter into the picture. After noting that they were of particular interest to him because of his participation in preparing the form for analyzing bank capital, he pointed out that use of the form indicated almost exactly the same percentage of capital deficiency in each case. However, use of the form could provide only a snapshot picture at one particular time and did not serve to answer the final question, for it was necessary to take into account many other factors, including apparent trends. For example, it might be asked whether a particular application represented one step in a large branch program or a relatively small step to maintain the bank's existing position. From the legal point of view, he felt that in either of the cases before the Board today a decision to approve or to deny could be supported. In the City Bank matter, he felt that the Board's decision was thoroughly defensible, and he also thought that a distinction between that case and this one would be defensible. In other words, there would not necessarily be a conflict in making different decisions in spite of the fact that use of the analysis form produced similar results.

Referring to previous comments by Governor Mills, Mr. Solomon observed that if a bank grows to a certain point it reaches the stage where the original organizers usually are not prepared to provide

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adequate capitalization. Studies in connection with the form for analyzing bank capital had indicated that banks in the size group of City Bank (deposits around \$100,000,000) tended more generally to be undercapitalized than banks in other size groups, which might afford some indication that banks in that range had reached a point where more capital was needed to enable them to go further.

Governor Mills said that he would be willing to accept the recommendation of the Division of Examinations and the reasoning expressed by Messrs. Nelson and Solomon. He pointed out that within the last year or so the Hadley Falls Trust Company had sold \$150,000 of additional common stock. At the same time, the bank retired its preferred stock and this resulted in a reduction of total capital. Even so, however, the bank had made an effort and had successfully accomplished the introduction of additional common shares. For a bank of this relatively small size (\$34 million total deposits), the sale of that amount of common stock could be considered rather substantial, since it represented something more than 10 per cent of the bank's total capital. There would appear to be a question as to how often the bank could go back to its shareholders for additional capital and how successful it might be in attracting new shareholders when one considered the size of the community and of the bank. As Mr. Nelson had indicated, when one looked at the whole trade area it seemed reasonable to encourage the growth of the smaller banks so that they

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might become stronger competitors of the large banks in Springfield.

In response to questions, Mr. Nelson discussed the relative size of City Bank and Hadley Falls Trust Company and the capital structure of each institution. He also commented on the repeated proposals of the Hadley Falls bank to retire its preferred stock, the history of the present management, and the extent of the financial interest of the present management in the bank. It appeared possible, he said, that the management could not buy much more stock at present; there was some indication that the bank would endeavor to continue on a dividend basis for five consecutive years after which its stock would be eligible for purchase by mutual savings banks. The bank's capital position, he acknowledged, had been a matter of debate between the Reserve Bank and the member bank for a long period of time, although at present the conflict was reported to be less severe.

Governor Robertson commented that it was only as the result of extreme pressure that the member bank agreed to sell new common stock when it retired its preferred stock. According to Mr. Latham, the degree of conflict between the bank's management and the Reserve Bank had now subsided, but the Reserve Bank was going to continue to use all available means to encourage the bank to improve its capital position. Mr. Latham, he noted, had said that he would not recommend approval of the application if he felt the bank was expanding.

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Governor Shepardson then stated that he would concur in the recommendation of the Reserve Bank and the Division of Examinations on the basis of the explanation made by Mr. Nelson, and Governor Balderston indicated that he too would concur.

Thereupon, it was agreed, Governor Robertson dissenting, to approve the branch application of Hadley Falls Trust Company. Copies of the letters sent to the applicant bank and to the Federal Reserve Bank of Boston pursuant to this action are attached as Items 3 and 4, respectively.

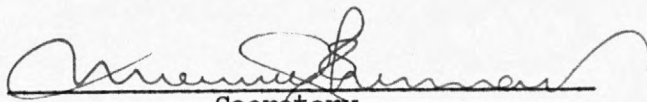
The meeting then adjourned.

Secretary's Note: Pursuant to the recommendations contained in memoranda dated February 6, 1959, from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board increases in the basic annual salaries of the following persons on the Board's staff, effective February 8, 1959:

Katherine G. Black, Statistical Assistant, Division of Research and Statistics, from \$4,325 to \$4,490.

Maurice H. Schwartz, Chief Analyst, Division of Research and Statistics, from \$10,850 to \$11,355.

Theodore A. Veenstra, Jr., Technical Assistant, Division of Bank Operations, from \$7,510 to \$8,330.

  
Secretary



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON 25, D. C.

Item No. 1  
2/6/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 6, 1959

Comptroller of the Currency,  
Treasury Department,  
Washington 25, D. C.

Attention Mr. W. M. Taylor,  
Deputy Comptroller of the Currency.

Dear Mr. Comptroller:

Reference is made to a letter from your office dated November 5, 1958, enclosing copies of an application to organize a national bank in the Merle Hay Plaza, Des Moines, Iowa, 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 a representative of the Federal Reserve Bank of Chicago discloses favorable findings with respect to the factors usually considered in connection with such proposals. However, it is reported that the Superintendent of Banking of the State of Iowa has approved the application to organize a State bank in the Merle Hay Plaza shopping center and since the area will not support two banking institutions there is not sufficient need for the proposed national bank. Accordingly, the Board of Governors recommends that the application be disapproved.

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.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,  
Assistant Secretary.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON 25, D. C.

Item No. 2  
2/6/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 6, 1959



Board of Directors,  
City Bank,  
Detroit, Michigan.

Gentlemen:

Reference is made to your application submitted through the Federal Reserve Bank of Chicago for permission to establish a branch at Ann Arbor Trail and Evergreen Road, Dearborn Township, Wayne County, Michigan.

The Board of Governors has been pleased to note the progress made by City Bank under the present management. However, its review of all available information has caused the Board to conclude that it would not be justified in approving this application because the present capital structure of City Bank is believed to be inadequate in relation to the volume of its business and insufficient to support the proposed expansion. While the Board can not find its way clear to approve the application at this time, it would be glad to reconsider the matter when provision is made for a satisfactory capital structure for your bank.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,  
Assistant Secretary.

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON 25, D. C.

Item No. 3  
2/6/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD



February 6, 1959

Board of Directors,  
Hadley Falls Trust Company,  
Holyoke, Massachusetts.

Gentlemen:

Pursuant to your request submitted through the Federal Reserve Bank of Boston, the Board of Governors of the Federal Reserve System approves the establishment of a branch in the vicinity of the intersection of James Street and Memorial Drive in the Fairview Section of Chicopee, Massachusetts, by Hadley Falls Trust Company, provided the branch is established within one year from the date of this letter and approval of the State authorities is in effect as of the date of the establishment of the branch.

While the present amount of capital structure of the trust company is not satisfactory, the establishment of this branch is being approved in view of the minimum of expansion involved and the convenience which it will afford present customers. The Board wishes to impress upon you the need for strengthening the capital structure of the trust company as rapidly as possible.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,  
Assistant Secretary.

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON 25, D. C.

Item No. 4  
2/6/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 6, 1959

Mr. Benjamin F. Groot, Vice President,  
Federal Reserve Bank of Boston,  
Boston 6, Massachusetts.

Dear Mr. Groot:

Reference is made to your letter of January 13, 1959, with regard to the request of Hadley Falls Trust Company, Holyoke, Massachusetts, for permission to establish a branch in the vicinity of the intersection of James Street and Memorial Drive in the Fairview Section of Chicopee, Massachusetts.

After consideration of the information submitted, the Board concurs in your recommendation and has approved the establishment of the branch as shown in the enclosed letter to be forwarded to the board of directors of the bank. Two copies are enclosed for your use.

It is understood that Counsel for the Reserve Bank will review and satisfy himself as to the legality of all steps taken to establish the branch.

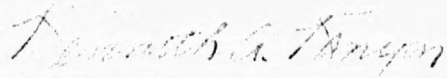
The Board has noted the continued undercapitalized position of this institution, and after giving due consideration to its substantial holdings of State, county and municipal obligations, and other favorable factors, it would appear that a minimum of \$500,000 of new capital funds would be required to bring its capital structure into an acceptable position. In view of normal growth expectations, it would not appear that the retention of earnings alone can be relied upon to cure the deficiency. It appears that the bank is faced with the alternatives of selling additional capital or of substantially reducing its volume of loans and/or other risk assets. In any event, the

Mr. Benjamin F. Groot

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Board of Governors would not be inclined to give favorable consideration to further expansion, branchwise, by this bank until and unless capital funds and risk assets are brought into a more acceptable relationship, and your efforts to bring about a strengthening of the bank's capital structure should be vigorously pursued.

Very truly yours,



Kenneth A. Kenyon,  
Assistant Secretary.

Enclosures 3