

Minutes for February 18, 1959.

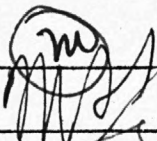
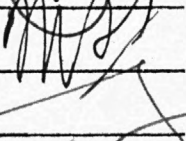
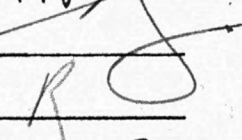
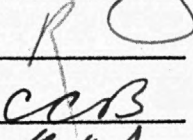
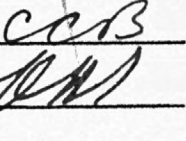
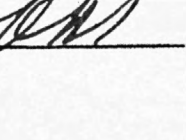
To: Members of the Board

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 Wednesday, February 18, 1959. The Board met in the Board Room at  
10:00 a.m.

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

Mr. Sherman, Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. Hackley, General Counsel  
Mr. Farrell, Director, Division of Bank  
Operations  
Mr. Hostrup, Assistant Director, Division  
of Examinations  
Mr. Smith, Assistant Director, Division  
of Examinations

Messrs. Herz, Hill, Drake, and Emery of  
Price Waterhouse & Co.

Examination techniques and procedures. The representatives  
of Price Waterhouse & Co. were present at the Board's request in order  
to discuss the report submitted by the accounting firm based on the  
1958 review of techniques and procedures followed by the Board's field  
examining staff. In its report the firm recommended that the Board  
consider having departmental surveys and/or audits made at each Reserve  
Bank from time to time during the year in lieu of the present practice  
of making a complete examination of each Bank once each year. A related  
suggestion was that the Board consider having the work performed by a  
decentralized examining staff, perhaps organized in four small groups,

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each of which would operate within a prescribed geographical area. The present method of examination was criticized as representing too much duplication of the work of the Reserve Bank audit staff and placing too little dependence on the internal audit function and the Bank's internal controls.

In introducing the discussion, Chairman Martin said that the Board regarded the Price Waterhouse document as a challenging and interesting report. He indicated that among other things the Board would like to have comment on whether it was felt that surveys or audits of the type suggested would constitute compliance with the mandate contained in section 21 of the Federal Reserve Act that the Board shall, at least once each year, order an examination of each Federal Reserve Bank.

Addressing himself first to the statutory requirement, Mr. Herz suggested that in a situation of this kind questions always tended to arise regarding the intent of the law. The statutes of the State of New York, he said, had been amended within the last 18 months or so with respect to directors' examinations of commercial banks, the change being to the effect that for the purpose of such examinations it would be appropriate to examine parts or segments of the bank at different times. Mr. Hill added that the change in the law reflected the situation as it already existed at some of the larger commercial banks.

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Mr. Herz continued by saying that the word "examination" was a rather flexible one and that he would be inclined to interpret the law rather broadly to make room for whatever seemed to be necessary. Developments and trends had already resulted in certain things recognized in the Price Waterhouse report, and to that extent the suggested procedures would not represent an innovation. If necessary, it might be possible to have the law amended to make clear the kind of examinations that the Board was developing. On the practical side, there was the problem that men assigned to the type of work envisaged by the report would have to be individuals of imagination and drive, whereas it had been observed that under present procedures much of the work tended to be accomplished under detailed guidance.

Mr. Hill commented that the concept of the auditor was changing in the whole field of banking. The emphasis of reviewing controls found in the Price Waterhouse report reflected the concept of an auditor superimposed on an organization that was supposed to operate accurately. Under that concept, the auditor would have the responsibility of reviewing the organization to see that it should produce accurate results and of making such tests as necessary for that purpose. This was different from the historical concept of the auditor who double-checked everything. In the last analysis, the individual banks should produce accurate, reliable figures by themselves and the auditor should look mostly at the operations that produced those results. This tended to make the checking procedure only secondary.

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Mr. Herz confirmed that this was a development now going on. Because of the sheer force of volume, he felt that somewhere along the line a start must be made on breaking the examinations into pieces. The first step along such lines might be to set up a group to study the proposed methods as a practical proposition and plan a pilot survey or surveys, the results of which would be subjected to careful review.

At this point Chairman Martin inquired of Mr. Herz what he felt the reaction of the General Accounting Office might be with regard to such a proposal, and the latter replied in terms that the Office, after study in the field of bank examination procedures, possibly would come up with something comparable in a general way. At least, the General Accounting Office would be apt to come up with a program involving more units of audit than twelve. If a document such as the Price Waterhouse report were submitted to the General Accounting Office for opinion, he felt that the Office might endorse it as a system of auditing.

Following a review by Governor Mills of his understanding as to the nature and principal effects of the Price Waterhouse proposals, Mr. Herz commented that what was proposed might be described as a considerably more decentralized program than carried on at present. However, he doubted whether the program would represent a complete departure as much as a recognition of what was now taking place. As he saw it, the auditors at the Reserve Banks had undertaken more and more auditing responsibility and the Board's staff had been placed in

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a position where it became increasingly necessary to place reliance on the work being done at the Reserve Banks. The Board's staff was in each Reserve Bank only one month or so out of the year, and for the rest of the year reliance had to be placed entirely upon the Reserve Bank auditor, except to the extent that contact was maintained through the Division of Bank Operations. While he was not thoroughly familiar with the surveys made by that Division, they appeared to constitute what might be called an auditing-type of activity. To the extent, however, that the Board was dependent on internal auditing controls, it seemed to him that a rather extensive degree of decentralization had already taken place. Under the proposed plan, more effort would be directed toward satisfying the Board that activities at the Reserve Banks throughout the year were proceeding in a satisfactory way. More effort would be directed toward determining that operating systems were sound, and less on the conventional type of bank examination.

Governor Szymczak inquired whether there was not a danger that the suggested regional groups might become in effect a part of the Reserve Banks to which they were assigned, and Mr. Hill agreed that the point was well taken. That situation, he said, was what tended to develop from having a resident auditor at each Bank, and Price Waterhouse would not suggest that the Board maintain a resident examining staff in each Bank. Mr. Herz added that at present the general auditor

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was actually an integral part of the Reserve Bank organization and that the difficulty referred to by Governor Szymczak seemed more or less inherent in the Federal Reserve organizational structure because of the impracticality of arranging rotation of auditors. He felt that it would be helpful to look into the auditor's activities more frequently than once each year and to see that the auditors were operating with a consciousness of the need for independence.

After some discussion of the advantages and disadvantages of maintaining regional examining groups from the standpoint of retaining competent personnel, Governor Robertson inquired whether Price Waterhouse would advocate shifting completely from the present system or detaching men from the field examining staff to make surveys on an experimental basis at a designated Reserve Bank.

In response, Mr. Herz emphasized the need for experimentation with a view to arriving at something that had been developed within the Federal Reserve System by people who would have to live with it. Pilot studies might involve a number of separate undertakings, and it would not appear to make too much difference whether or not they were conducted in one Reserve Bank or several Banks. There might also be the possibility of visiting some commercial bank that had moved toward such a type of examination procedure.

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Governor Shepardson inquired whether a distinction should not be drawn between an auditor in a commercial bank checking operations for the benefit of the management and examiners of supervisory agencies checking such operations from the standpoint of the public interest. To this, Mr. Herz replied that the steps making up an examination tended to be quite similar no matter who was making the examination. He recognized that the interest of an examiner for a supervisory agency was somewhat different from that of an auditor for a commercial bank, and somewhere in between there was the interest of the examining committee of the board of directors.

Chairman Martin inquired about the accuracy of any charge that the Federal Reserve System was self-auditing, and Mr. Herz replied in terms that the Federal Government might be said to be self-auditing to the extent that its operations were examined by the General Accounting Office. The way Federal Reserve System activity was organized, he would be inclined to say that the System was not a self-auditing organization. Within each Reserve Bank, however, the auditing function must be considered as part of the structure of the particular Bank. The objective was to see that the Bank was fragmented within itself so that no hazards would exist through combination of duties.

Inquiry was made regarding the Price Waterhouse appraisal of the functions of the Division of Bank Operations, and Mr. Herz again



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stated that he was not completely familiar with the work of that Division. Among other things, however, he understood that the Board brought its influence to bear through reviewing the budgets of the Reserve Banks, which tended to substitute Board for Bank judgment on certain things. The work of the Division of Bank Operations, while not strictly an auditing activity, enabled analyses to be made of judgments reached at the Federal Reserve Banks, and there was the possibility of making modifications. This was a type of activity which permitted the Board to inject itself into the Reserve Banks' affairs; whether the Board actually did inject itself into such affairs was a question for determination by the Board in any particular circumstances.

Governor Balderston referred to situations where there might be differences between the Board and the management of a Reserve Bank regarding interpretation of System policies and rulings, and Mr. Herz commented that such matters could be reported by the Division of Bank Operations to the extent that they were not reported through the examination function.

Speaking for the Division of Examinations, Mr. Smith said he had received the impression from this discussion that the fragmented examination approach was being more or less forced upon commercial banks by the natural process of developments. On the other hand, he said, it was still possible to conduct a complete examination of a

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Federal Reserve Bank at any given time. This was not a new problem, for the Board had been examining the Reserve Banks for some 40 years. He inquired, therefore, as to the shortcomings seen in the present program and whether the advantages envisaged in adopting a new approach would justify the administrative problems posed by it.

Mr. Herz responded that Price Waterhouse had endeavored to indicate the answer in its report. As that firm saw it, however, the disadvantages of the present system were associated generally with the degree to which the Board was placed in the position of relying on the auditing function at the Reserve Banks for eleven months out of the year. The proposed approach was intended to bring those functions under more frequent scrutiny.

There followed some discussion regarding the problem of recruitment of appropriate personnel during which the view was expressed by Price Waterhouse that this problem might be ameliorated because of the challenging and nonroutine nature of the assignments under a program such as outlined in the report.

At the conclusion of the discussion, Mr. Herz again suggested considering the proposals in theory and then experimenting with them. He said that although Price Waterhouse personnel would be available for any consultation that might be requested, the problem was principally one to be solved within the Board's organization.

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The Price Waterhouse representatives then left the room along with Messrs. Farrell and Smith. Mr. Nelson, Assistant Director, Division of Examinations, joined the meeting at this point.

Items circulated to the Board. The following items, which had been circulated to the members of the Board and copies of which are attached to these minutes under the respective item numbers indicated, were approved unanimously:

	<u>Item No.</u>
Letter to the Farmers and Merchants Trust Company of Chambersburg, Chambersburg, Pennsylvania, approving the establishment of a branch in Marion, Pennsylvania, incident to its proposed merger with the Marion Bank. (For transmittal through the Federal Reserve Bank of Philadelphia)	1
Letter to The Croghan Colonial Bank, Fremont, Ohio consenting to its absorption of The Commercial Bank Company, Green Springs, Ohio, and approving the establishment of a branch in Green Springs. (For transmittal through the Federal Reserve Bank of Cleveland)	2
Letter to the Comptroller of the Currency recommending unfavorably with regard to an application to organize a national bank at Bailey's Crossroads, Virginia. (With a copy to the Federal Reserve Bank of Richmond)	3
Letter to the Bureau of the Budget commenting on a draft bill "To amend certain laws of the United States in light of the admission of the State of Alaska into the Union, and for other purposes."	4
Memorandum from Mr. Walter Young regarding a request from the Bureau of the Budget for a report on proposed legislation relating to the use of certified mail by Government agencies.	5

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Messrs. Hostrup and Nelson then withdrew and Messrs. Johnson, Director, Division of Personnel Administration, Marget, Director, and Sammons, Associate Adviser, Division of International Finance, entered the room.

Renewal of gold loan to Bolivia (Item No. 6). In a telegram dated February 16, 1959, the Federal Reserve Bank of New York requested that the Board approve, subject to authorization by its directors at their meeting tomorrow, a further renewal for two months of the \$600,000 gold loan to the Central Bank of Bolivia which was originally granted on October 20, 1958. The reason given for the requested renewal was that negotiations had not yet been completed for the extension of a credit to the Central Bank by a United States commercial bank, the proceeds of which were to be used in part to repay the Federal Reserve gold loan.

After discussion of the Bolivian economic situation and of the circumstances involved in the present request for extension, a two-month renewal of the gold loan to the Central Bank of Bolivia was approved unanimously. Doubt was expressed, however, as to whether there would be justification for complying with any request for further renewal. It was understood that the Division of International Finance would keep in touch with the New York Reserve Bank regarding developments in connection with the gold loan and that the Division would keep closely informed with regard to economic and financial developments in Bolivia.

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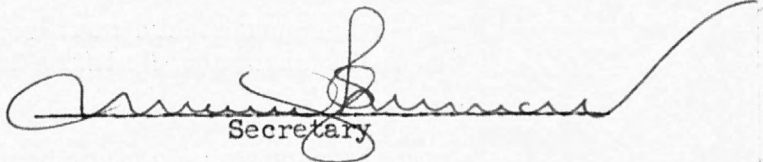
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A copy of the telegram sent to the Federal Reserve Bank of New York pursuant to this action is attached as Item No. 6.

All of the members of the staff except Messrs. Sherman, Kenyon, and Johnson then withdrew from the meeting.

Officer salaries at Dallas Reserve Bank (Item No. 7). Following comments by Mr. Johnson based on a file which had been circulated to the Board, unanimous approval was given to a letter to the Federal Reserve Bank of Dallas approving the payment of salaries to certain specified officers of the Bank at rates fixed by the Board of Directors. A copy of the letter is attached as Item No. 7.

The meeting then adjourned.

  
Secretary

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

Item No. 1  
2/18/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 1959.

Board of Directors,  
Farmers and Merchants Trust Company of Chambersburg,  
Chambersburg, Pennsylvania.

Gentlemen:

Pursuant to your request submitted through the Federal Reserve Bank of Philadelphia, the Board of Governors approves the establishment of a branch on Colorado Street, Marion, Pennsylvania, by Farmers and Merchants Trust Company of Chambersburg, Chambersburg, Pennsylvania. This consent is given provided:

- (a) The merger with Marion Bank, Marion, Pennsylvania, is effected substantially in accordance with the terms of the Joint Plan of Merger dated December 23, 1958;
- (b) Shares of stock acquired from dissenting shareholders are disposed of within six months after date of acquisition;
- (c) The branch is established within six months from the date of this letter; and
- (d) That formal approval of the State authorities is effective at the time the branch is established.

Marion Bank has in its investment portfolio \$5,000 par value Pennsylvania Turnpike revenue bonds, Delaware River extension, dated September 1, 1952, and due June 1, 1970. Inasmuch as these bonds have been ruled ineligible for purchase by member banks, consideration should be given to disposing of them within a reasonable period of time.

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  
2/18/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 1959.



Board of Directors,  
The Croghan Colonial Bank,  
Fremont, Ohio.

Gentlemen:

The Board of Governors of the Federal Reserve System hereby gives its consent under the provisions of Section 18(c) of the Federal Deposit Insurance Act to the absorption of The Commercial Bank Company, Green Springs, Ohio, by The Croghan Colonial Bank, Fremont, Ohio, and approves the establishment of a branch in Green Springs, within the limits of Sandusky County, Ohio, by The Croghan Colonial Bank, provided,

- (1) The proposed absorption and establishment of the branch are effected within six months from the date of this letter and substantially in accordance with the agreement between the parties dated December 16, 1958,
- (2) Investment securities and fixed assets acquired from The Commercial Bank Company, are not placed on the books of The Croghan Colonial Bank in amounts in excess of the market value and the depreciated value for Federal income tax purposes, respectively, and
- (3) Formal approval is obtained from the State authorities.

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  
2/18/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 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 October 28, 1958, requesting a further reconsideration and recommendation with respect to the application dated August 2, 1956 to organize a national bank at Bailey's Crossroads, Virginia.

A reinvestigation of the application based upon the revised information submitted has been made by an examiner for the Federal Reserve Bank of Richmond, and it appears from the information available that the proposed capital structure and management of the bank would be reasonably satisfactory. It should be noted, however, that one of the organizers, Mr. Thomas, now serving as a director of a bank in Alexandria, may be prohibited under the Clayton Act from serving as an officer and director of the proposed bank. The prospects for profitable operation of the bank are not very favorable, and there does not appear to be a sufficient need for a bank at this location at the present time. In view of these unfavorable factors, the Board of Governors does not feel justified in recommending approval of the application.

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

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  
2/18/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 1959.

Mr. Phillip S. Hughes,  
Assistant Director for  
Legislative Reference,  
Bureau of the Budget,  
Washington 25, D. C.

Dear Mr. Hughes:

This is in response to your legislative referral memorandum of February 3, 1959, enclosing a draft bill "To amend certain laws of the United States in light of the admission of the State of Alaska into the Union, and for other purposes."

The only provisions of the draft bill which relate directly to the Federal Reserve System are those of section 8 which would amend section 14(b) of the Federal Reserve Act (12 USC 355) to insert the phrase "(including Alaska)" after the words "continental United States", and which would amend section 19 of that Act by striking out the words "in Alaska or". The Board sees no objection to these amendments.

However, it is suggested that rather than amend section 14(b) as noted in section 8(a) of the draft bill, an amendment might be made to section 1 of the Federal Reserve Act (12 USC 221) by deleting the period at the end of the section and adding thereto "; the term 'the continental United States' means the States of the United States and the District of Columbia." The first sentence of section 2 of the Federal Reserve Act (12 USC 222) assumes that Alaska is now considered to be included in the "continental United States". The Board, therefore, questions the necessity of amending section 14(b) of the Federal Reserve Act and instead recommends that the proposed amendment as contained in section 8(a) of the draft bill be deleted, and that the proposed amendment to section 1 of the Federal Reserve Act, as noted above, be inserted in lieu thereof.



Mr. Phillip S. Hughes

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In keeping with the objectives of this draft bill and in conformity with the recommendation appearing in the preceding paragraph, it is suggested that consideration might also be given to the insertion of an amendment to section 15 of the Gold Reserve Act of 1934 (31 USC 444) and section 10 of the Silver Purchase Act of 1934 (31 USC 448b) to change the words "the States of the United States, the District of Columbia, and the Territory of Alaska" to read "the States of the United States and the District of Columbia".

In the event the suggested change is not made in the proposed amendment, section 8(a) of the draft bill as it now reads should incorporate therein a similar amendment to section 19, paragraph 11 (12 USC 466) of the Federal Reserve Act.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

Item No. 5  
2/18/59

Office Correspondence

Date February 11, 1959.

Board of Governors

Walter H. Young

Subject: Bureau of the Budget request for report on proposed legislation relating to use of certified mail by Government agencies

The Board is in receipt of a Legislative Referral Memorandum from the Bureau of the Budget dated February 4, 1959, requesting the Board's views on a legislative proposal submitted by the Postmaster General. A similar request has been sent to all Government departments and agencies. This proposal would apply to agencies of the Government which are now by law required or permitted to use registered mail for transmittal of various classes of documents. In brief, the legislation would authorize or permit those agencies to use either registered or certified mail. Apparently the Postmaster General favors the proposal for the reason that certified mail service is not nearly as expensive from the standpoint of the Post Office Department as is registered mail.

Subsection (a) of the proposal would amend 38 separate provisions of law relating to particular agencies. Subsection (b) provides that return receipts for the delivery of certified mail shall be prima facie evidence of delivery to the same extent as return receipts for registered mail.

I have been informed by Mr. Henry Miller in the Office of the Superintendent of Postal Service for the District of Columbia that certified mail is a form of mail service which was instituted in October of 1958. He told me that it is used in the case of first class mail which has no intrinsic value and, therefore, no indemnity is provided in the event of loss which, of course, is provided in the case of registered mail. In the case of either certified mail or registered mail, return receipts may be provided.

I have also discussed the above with Mr. John B. Holden of the Bureau of the Budget who is handling the proposal for the Bureau. I explained to him that there is no provision in the Federal Reserve Act requiring the use of registered mail, although Federal Reserve notes are shipped either as registered mail or treated as registered mail in accordance with an administrative arrangement between the Board of Governors and the Post Office Department. I told him that, after studying the proposed legislation and the explanation accompanying it, I had concluded that it would have no effect on the present arrangement between the Board of Governors and the Post

Board of Governors

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Office Department but that I wished to discuss the bill with him in order to secure such other information as he might have. He expressed the view that the bill was not intended to, and would not, affect the Federal Reserve System in any way since it was intended to apply only to those agencies now operating under an express statute requiring or permitting the use of registered mail.

The Bureau's Referral Memorandum does not request a written report if the Board has no express statute relating to registered mail and if the draft bill is satisfactory to the Board. Accordingly, it is recommended that the Bureau of the Budget be advised by telephone that the Board has no objection to the proposed legislation.

**TELEGRAM**  
**BOARD OF GOVERNORS**  
**OF THE**  
**FEDERAL RESERVE SYSTEM**  
**LEASED WIRE SERVICE**  
**WASHINGTON**

Item No. 6  
2/18/59

February 18, 1959.

EXTER - NEW YORK

Your wire February 16. Board approves subject to authorization by your directors further renewal for two months from February 20 of loan on gold by your Bank to Banco Central de Bolivia of \$600,000 on same terms and conditions as those of maturing loan.

It is understood that the usual participations will be offered to the other Federal Reserve Banks.

(Signed) Merritt Sherman

SHERMAN

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

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Item No. 7  
2/18/59

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD



CONFIDENTIAL (FR)

Mr. Watrous H. Irons, President,  
Federal Reserve Bank of Dallas,  
Dallas 2, Texas.

Dear Mr. Irons:

The Board of Governors approves the payment of salaries to the following officers of the Federal Reserve Bank of Dallas for the period and at the rates indicated, which are the rates fixed by your Board of Directors as reported in your letter of February 12, 1959:

<u>Name</u>	<u>Title</u>	<u>Annual Salary</u>
<u>For the period March 1 through December 31, 1959 -</u>		
	<u>Head Office</u>	
James L. Cauthen	Vice President	\$12,100
George F. Rudy	General Counsel and Assistant Secretary	12,100
Roy E. Bohne	Assistant Cashier	9,800
Robert H. Boykin	Assistant Counsel	8,000
<u>For the period April 1 through December 31, 1959 -</u>		
	<u>Head Office</u>	
Thomas R. Sullivan	Assistant Cashier	\$10,500
	<u>Houston Branch</u>	
Rasco R. Story	Assistant Cashier	\$ 8,800
	<u>San Antonio Branch</u>	
Carl H. Moore	Vice President	\$13,400

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.