Minutes for April 15, 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	
Gov. King	x	

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Minutes of the Board of Governors of the Federal Reserve System on Wednesday, April 15, 1959. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Mills
Mr. Robertson 1/
Mr. Shepardson
Mr. King

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Fauver, Assistant Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Molony, Special Assistant to the Board
Mr. Shay, Legislative Counsel
Mr. Noyes, Adviser, Division of Research and Statistics
Mr. Solomon, Assistant General Counsel
Mr. Hexter, Assistant General Counsel
Mr. Hostrup, Assistant Director, Division of Examinations
Mr. Benner, Assistant Director, Division of Examinations
Mr. Hill, Assistant to the Secretary
Mr. Hooff, Assistant Counsel
Mr. Young, Assistant Counsel
Mr. Huning, Review Examiner, Division of Examinations
Mr. Collier, Chief, Current Series Section, Division of Bank Operations

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

1/ Withdrew from meeting at point indicated in minutes.

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	Item No.
Letter to the Committee on Common Trust Funds, Trust Division of the American Bankers Association, regarding the suggested addition of certain footnotes to Regulation F.	1
Letter to the Bureau of the Budget interposing no objection to a draft bill, submitted by the Treasury, to repeal or amend certain obsolete statutes relating to national banks.	2
Letter to Congressman Auchincloss of New Jersey concerning the application of the margin requirements to executive stock options. 1/	3

Mr. Young then withdrew from the meeting.

Omnibus bill to repeal obsolete provisions of the Federal Reserve Act. Pursuant to the discussion at the meeting on April 1, 1959, there had been distributed to the Board a memorandum from Mr. Hackley dated April 8, 1959, submitting a draft of omnibus bill to eliminate obsolete provisions in the Federal Reserve Act, a section-by-section explanation of the bill, and a draft of letter that might be sent to the Chairmen of the Senate and House Banking and Currency Committees requesting introduction of the bill.

Mr. Hackley, in commenting on the draft bill, stated that the proposed amendments were previously recommended by the Board in 1956 in connection with the "Financial Institutions Act". Those amendments

1/ Governor Balderston stated that the letter had been prepared at his request as the result of a telephone conversation during which Congressman Auchincloss cited arguments in favor of according special treatment in the Board's regulations with respect to executive stock options, and he (Governor Balderston) explained the position taken by the Board upon considering the matter on several occasions.

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would not make changes of substance or appear to be controversial. However, by virtue of the subject matter, some of them might give rise to collateral questions.

Mr. Hackley noted that there were in addition two changes not recommended in 1956 that the Board might wish to include. These were (1) an amendment to section 19 of the Federal Reserve Act as follows: "National banks, or banks organized under local laws, located ~~in Alaska or~~ in a dependency or insular possession or any part of the United States (OTHER THAN A STATE) outside the continental United States..." may remain nonmember banks; and (2) an amendment to section 25(a) to require each Board member to certify to the Secretary of the Board, rather than to the Secretary of the Treasury, that he is not an officer, director, or stockholder of a foreign banking corporation. The latter, he pointed out, would be a minor change of substance.

Discussion of the draft bill disclosed a unanimity of opinion that, if such legislation were to be proposed, it would be preferable not to include amendments with regard to the composition of the Board of Governors or the salaries provided for the members of the Board. Also, since a minor change of substance would be involved and the existing statutory provision presented no practical difficulty, it was the view that the suggested amendment to section 25(a) should not be included.

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Question then was raised whether the circumstances were propitious for requesting introduction of such a bill, and it was agreed that it would be desirable for the Vice Chairman to confer with the Chairmen of the Senate Banking and Currency Committee and Subcommittee #2 of the House Banking and Currency Committee before any further steps were taken.

Mr. Riefler then withdrew from the meeting.

Reserve requirement legislation (Item No. 4). With reference to the discussion at the meeting on April 10, 1959, concerning a letter that might be transmitted to appropriate parties in the Congress to explain the problems that would be created by reserve requirement legislation containing a provision for elimination of the central reserve city classification, Governor Balderston reported that he had handed such a letter to Chairman Brown of Subcommittee #2 of the House Banking and Currency Committee. In addition, he had informed Chairman Robertson of the Senate Banking and Currency Committee that such a letter was being handed to Mr. Brown, but Mr. Robertson, although apparently pleased to be kept informed, did not express a desire for a letter.

Governor Balderston went on to summarize the meeting at which the letter was transmitted to Congressman Brown, the tenor of which suggested doubt as to the prospect of favorable consideration by the House of a bill providing for retention of the central reserve city classification.

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A copy of the letter handed to Congressman Brown is attached as Item No. 4.

Mr. Thomas then withdrew from the meeting.

Transfer of authority over trust activities. The Bureau of the Budget, under date of February 10, 1959, had requested the Board's views on a draft bill submitted by the Treasury Department on behalf of the Comptroller of the Currency "To transfer from the Board of Governors of the Federal Reserve System to the Comptroller of the Currency authority over trust activities of national banks." The proposed bill would transfer from the Board to the Comptroller authority (1) to grant to national banks the right to act in fiduciary capacities, and (2) to promulgate regulations governing the exercise of fiduciary powers by national banks. However, authority to regulate the collective investment of trust funds by national banks would continue to be vested in the Board of Governors.

There had been distributed to the Board memoranda from Mr. Hexter and the Division of Examinations dated March 30 and April 10, 1959, respectively. The recommendation contained in Mr. Hexter's memorandum was that the Board (1) support the Treasury bill with respect to its major provisions, but (2) oppose the provision that would leave authority to regulate common trust funds in the Board of Governors. A draft of

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reply to the Bureau of the Budget reflecting this position was submitted with his memorandum. The Division of Examinations recommended that the Board report favorably on all provisions contained in the Treasury proposal.

During discussion, members of the Legal Division commented on various aspects of the proposal. It was brought out, among other things, that the Board's regulatory authority related only to trust activities of national banks, although section 584 of the Internal Revenue Code of 1954 provides tax exemption for any common trust funds operated under the Board's regulations. Accordingly, common trust funds of State-chartered banks must conform to section 17 of Regulation F, Trust Powers of National Banks, in order to qualify for tax exemption. In connection with a question whether regulatory authority over common trust funds of national banks might be transferred to the Comptroller while the Board retained similar authority with respect to State-chartered banks, it was pointed out that this would involve a duplication of work and, in addition, might lead to different regulations for the two classes of banks. It was noted that even under the transfer of authority proposed by the Legal Division the System would continue to be responsible for the examination of trust departments of State member banks.

Governor Mills expressed a preference for the Treasury's proposal, which would not shift the regulation of common trust funds, on the basis that under the dual banking system it would not be desirable

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to vest in the Comptroller of the Currency authority over the activities of State banks. Although, as brought out in the proposed letter, all member banks have been subject for many years to the Investment Securities Regulation promulgated by the Comptroller, he felt that a distinction could be drawn between a promulgation of specific standards and a regulatory function in respect to trust activities.

Governor Robertson indicated that his preference would be to follow the recommendation of the Legal Division, which he felt was supported by the logic of the situation. The other course would result in the Board being left with responsibility for only a minor portion of the regulatory area and in such circumstances it might be difficult to retain the necessary administrative competence. State banks, he noted, would not be obliged to abide by the regulations of the Comptroller except to the extent that they desired to gain a tax advantage in the operation of common trust funds.

The discussion that followed was devoted principally to the development of distinctions between the responsibility for promulgating regulations and the responsibility for the examining function. It was brought out, among other things, that State member banks conduct a large volume of trust business and hold a predominant position in the operation of common trust funds. As previously noted, the trust departments of those banks would continue to be examined by the Federal Reserve System.

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At the conclusion of the discussion, the letter to the Bureau of the Budget, amended to reflect a position favoring enactment of the bill proposed by the Treasury, was approved, Governor Robertson voting "no" and Governor King not voting.

Secretary's Note: Governor Shepardson subsequently requested that transmittal of the letter to the Bureau of the Budget be deferred in order to permit further discussion of the matter.

Messrs. Hooff and Huning withdrew from the meeting at this point; Mr. Eckert, Chief, Banking Section, Division of Research and Statistics, entered the room; and Mr. Thomas returned to the meeting.

Replies to questions from Congressman Multer. There had been distributed to the Board draft replies to a series of 45 questions submitted on behalf of Congressman Multer, who was unable to attend the hearing on April 7, 1959, regarding H. R. 5237, a bill to amend section 19 of the Federal Reserve Act relating to reserve requirements to be maintained by member banks. Lists of questions also had been sent to the Comptroller of the Currency and the Federal Deposit Insurance Corporation, and there had been an exchange of opinions at the staff level in the preparation of the draft replies.

In discussion, the Board's attention was directed especially to the proposed replies to certain questions which were of other than a statistical or informational nature.

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With respect to question 44, which related to the practices followed by Federal Reserve bank examiners in counting cash, the consensus of the Board was to give a direct and informative answer. In regard to questions 33 and 34, which related to H. R. 1032, a bill regarding reserve requirements introduced by Mr. Multer on January 7, 1959, the consensus was to make the answer responsive and self-sufficient rather than to provide reference to earlier letters from the Board. Alternative drafts had been submitted in connection with questions 29 and 30, which inquired as to banks larger than banks in the next higher reserve classification, and certain suggestions were made for incorporation of portions of one draft in the other.

At the conclusion of the discussion, agreement was reached on a set of replies considered appropriate, and it was understood that Mr. Shay would arrange for their transmittal at the appropriate time to the House Banking and Currency Committee in order that they might be included in the record of the hearing. It was understood that copies of the replies would be transmitted to the Federal Deposit Insurance Corporation and the Comptroller of the Currency for their information.

Governor Robertson then withdrew, along with Messrs. Thomas, Shay, Noyes, Farrell, Eckert, and Collier. Mr. Nelson, Assistant Director, Division of Examinations, joined the meeting at this point.

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Proposed absorption of City Bank by American Security. There had been distributed to the Board memoranda from the Division of Examinations and the Legal Division dated March 30 and April 6, 1959, in connection with a request from the Comptroller of the Currency dated March 25, 1959, for the Board's views on the proposed absorption of the City Bank, Washington, D. C., by the American Security & Trust Company, also of Washington, in relation to the provisions of section 7 of the Clayton Act.

After a discussion of the local banking situation and preliminary expressions of opinion with respect to the type of reply that should be made to the Comptroller, the matter was put over for further consideration at another meeting of the Board.

The meeting then adjourned.

Secretary's Note: Pursuant to recommendations contained in memoranda 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 April 19, 1959:

Name and Title	Division	Basic annual salary From	To
Mary Jane Haymaker, Clerk	Office of the Secretary	$4,340	$4,490
Bernard N. Freedman, Economist	Research and Statistics	8,810	9,050
Francis D. Dargo, Assistant Federal Reserve Examiner	Examinations	5,580	5,730

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Salary increases, effective April 19, 1959 (continued)

Name and Title	Division	Basic annual salary From	To
Thomas G. Young, Assistant Federal Reserve Examiner	Examinations	$4,490	$4,640
Shirley V. Register, Secretary	Office of the Controller	4,190	4,340
Ruth Anna Brown, Telegraph Operator	Administrative Services	4,340	4,490
Paul G. Hutts, Operator, Tabulating Equipment	Administrative Services	4,490	4,640
Lola A. Buckley, Telephone Operator	Administrative Services	3,590	3,685

Secretary

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

Item No. 1
4/15/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 15, 1959

Mr. Hollis B. Pease, Chairman,
Committee on Common Trust Funds,
Trust Division of the
American Bankers Association,
The Hanover Bank,
New York 15, New York.

Dear Mr. Pease:

Reference is made to your letter of June 20, 1958, with which you enclosed a proposal and a supporting memorandum by the Committee on Common Trust Funds of the Trust Division of the American Bankers Association, suggesting the addition of footnotes to Sections 17(c)(2) and 17(c)(6) of Regulation F of the Board of Governors of the Federal Reserve System. These sections of the Regulation prohibit the admission or withdrawal of funds to or from a common trust fund if the fund contains any investments which would be unlawful investments for any of the trusts participating therein. The Committee feels that there is confusion as to what is an unlawful investment for purposes of the Regulation and it proposes that the Board add footnotes to the subject sections which would clarify the meaning of those provisions in respect to common stocks. The proposed footnotes provide, in effect, that a common stock which has passed a dividend shall not be considered, per se, as an unlawful investment.

The sentences of the subject sections of Regulation F which would receive the benefit of the footnotes are as follows:

Section 17(c)(2)

"Before permitting any funds of any trust to be invested in a participation in a Common Trust Fund, the trust investment committee shall review the investments comprising the Common Trust Fund; and, if it finds that any such investment* is one in which funds of such trust might not lawfully be invested at that time, funds of such trust shall not be invested in a participation in such Common Trust Fund." (Underscoring and asterisk added.)

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Section 17(c)(6)

"Before any distribution in cash is made, the trust investment committee shall determine whether any investment* remaining in the Common Trust Fund would be unlawful for one or more participating trusts if funds of such trusts were being invested at that time; and no distribution shall be made in cash until any such unlawful investment shall have been eliminated from the Common Trust Fund . . . ." (Underscoring and asterisk added.)

The footnotes which the Committee proposes to add, with reference points in the places indicated by asterisks, are as follows:

"Subject to applicable State law, the omission of dividends on a common stock held in the Common Trust Fund, shall not, in itself, for the purpose of this regulation, necessarily disqualify such common stock as a proper investment."

At the outset, it should be noted that the first paragraph of Subsection 17(c) of Regulation F provides that "All participations in such a Common Trust Fund shall be on the basis of a proportionate interest in all of the assets of the Common Trust Fund." This means that an investment in the common trust fund is an investment in a proportionate undivided interest in each and every asset held in the fund. Thus, the determination as to whether an investment might be unlawful for one or more participating trusts, as required by Sections 17(c)(2) and (6), applies individually to each and every asset held in the fund.

Regulation F is designed to regulate the proper exercise of fiduciary powers granted to national banks under the authority of Section 11(k) of the Federal Reserve Act. Although the primary reason for promulgation of Section 17 of Regulation F was to provide operational rules for common trust funds under which participants might receive certain tax benefits, and the application of the Regulation is extended to other than national banks because of this tax law, there is no difference in the purview of Section 17 from other sections of the Regulation. Accordingly, the Regulation sets out a number of procedural rules for the operation of trust departments of national banks. It is not, however, within the province of a Federal regulation to prescribe substantive law governing the rights and duties of persons in respect to matters affecting the administration of individual trusts. These are matters which are solely within the jurisdiction of State law.

In framing Regulation F, the Board gave recognition to this fundamental limitation in the effect of its Regulation F. Thus, Sections 10(a) and 10(b) provide that fiduciary funds shall

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be invested in strict accordance with the will, deed, or other instrument creating the trust and, in the absence of investment discretion, in investments in which fiduciaries in the State may invest. In a like manner, the questioned language of Sections 17 (c)(2) and 17(c)(6) refers also to the terms of underlying instruments and State law, although the reference is not stated specifically. It should be clear, then, that the determination as to whether an investment is one in which the funds of a given trust might lawfully be invested is a matter which must be decided by the terms of the underlying instrument and applicable State law. Regulation F is not designed to provide tests which would be controlling in this respect.

In a situation in which a common trust fund holds one or more common stocks which have passed regular dividends, the trust committee must determine from the terms of the respective underlying instruments, as viewed in the light of State law, that every trust participating or to be participated in the fund would be permitted to purchase such common stock or stocks at that time. Since this is what the proposed footnotes, in effect, state, nothing would be actually added to the fiduciary authority of the bank and the legal situation would remain unchanged. Therefore, the proposed footnotes are believed to be unnecessary. In addition, it is possible, if the proposed footnotes were adopted, that a fiduciary might be misled into believing that the Regulation authorizes participation in or withdrawal of funds from a common trust fund which holds common stocks which have passed a dividend. This would, of course, be undesirable, for, as was stated above, it is not within the purview of the Regulation to invade the area of substantive trust law. Accordingly, the Board is of the opinion that the proposed footnotes are not necessary or desirable additions to Regulation F.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 2
4/15/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 15, 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 March 23, 1959, requesting the Board's views on Treasury's draft bill "To repeal or amend certain statutes relating to national banks, which have become wholly or partly obsolete."

The Board notes that the draft bill would make no actual substantive changes in existing law and simply accomplishes the purpose indicated by the title. You are advised that the Board has no objection to favorable consideration of this proposal.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 3
4/15/59

OFFICE OF THE VICE CHAIRMAN

April 15, 1959.

The Honorable James C. Auchincloss,
House of Representatives,
Washington 25, D. C.

Dear Mr. Auchincloss:

This is in reply to your telephone inquiry on Monday of this week concerning the application of the margin requirements prescribed in the supplements to this Board's Regulations T and U to executive stock options.

In recent years the Board has received a number of proposals to amend the regulations so as to exempt purchases of stock under executive stock options from the margin requirements that are effective for other purchases. The Board has studied these proposals carefully, and from time to time has re-examined the considerations that bear upon this rather difficult question--most recently only a few months ago.

As a result of that re-examination, the Board concluded, and is still of the view, that while arguments can be advanced on both sides, it would not be desirable to adopt such an amendment to the regulations at this time.

It should be noted that Regulations T and U contain special provisions relating to credit for the acquisition of stock through the exercise of rights issued to stockholders. Under these special provisions executives of a corporation have, of course, the same privileges as all other persons. An amendment to give them greater privileges, and ones that are not generally available to others, would seem to be concerned chiefly with problems of executive compensation rather than questions of credit or credit regulation. In view of the purposes of the credit regulations, it seems doubtful that such special credit privileges would be an appropriate means of attempting to solve problems which appear to be essentially noncredit in character.

Sincerely yours,

(Signed) C. Canby Balderston

C. Canby Balderston,
Vice Chairman.

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

Item No. 4
4/15/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 13, 1959.

The Honorable Paul Brown,
Chairman, Subcommittee #2,
House Committee on Banking and Currency,
House of Representatives,
Washington 25, D. C.

Dear Mr. Brown:

During your subcommittee's hearings on the bill H.R. 5237, relating to reserve requirements for member banks of the Federal Reserve System, certain witnesses proposed that New York and Chicago be reclassified as reserve cities and that the central reserve city classification be stricken from the law. As you probably know, the Senate Banking and Currency Committee has ordered favorably reported the bill S. 1120 with an amendment which would reclassify New York and Chicago as reserve cities and remove the central reserve city classification from the law.

If the Congress should pass the bill in this form, it would raise some practical problems that we wish to call to your attention. You will recall that in the statement that I presented to your subcommittee it was pointed out with respect to the proposal to abolish the central reserve city classification:

> "* * * The change would necessitate either a reduction in central reserve city requirements or an increase in those for reserve cities, or both. If requirements at central reserve city banks were lowered to the present level of reserve city banks, the effect would have to be absorbed by raising requirements for country banks, if necessary to maintain an appropriate total level of required reserves. If the total level of required reserves were lowered, the additional reserves would need to be absorbed by other means to avoid undue credit expansion. In any event, there would be a realignment of requirements that would alter long-established relationships among banks; the present central reserve city banks would have lower requirements and country banks would probably have higher requirements relative to the average for all member banks than would be the case if the three-way classification were retained."

Under the bill as ordered reported by the Senate Committee, the abolition of the central reserve city classification would become immediately effective. Unless the Board at the same time permitted banks to

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count some portion of their vault cash as reserves, the effective reserve needs (required reserves plus vault cash holdings) for reserve city banks, particularly for the smaller ones with large vault cash holdings, would be higher than the effective requirements for the principal New York and Chicago banks. This would be the case because reserve city banks on the average hold vault cash amounting to about 1.6 per cent of net demand deposits, while cash holdings of the leading banks in New York City and Chicago average only 0.6 per cent.

Such inequity could be reduced to some extent by immediate action on the part of the Board to permit banks to count a substantial portion of their vault cash holdings as reserves with a simultaneous offsetting increase of reserve requirement percentages for member banks--country banks as well as reserve city banks.

Simultaneous action along these lines would make it possible to effect the transition of central reserve city banks to the new basis without granting them a preferred status with respect to reserve city banks that hold larger amounts of vault cash and without releasing undue amounts of reserves. It would not result in raising effective requirements for country banks or reserve city banks in case the increase in requirements were no greater than their vault cash holdings, although it would raise their requirement percentages more than would otherwise be necessary.

The Board is concerned that your Committee and all parties interested in this bill be advised of the immediate problem that will arise and of the solution for it that will have to be adopted. In this connection it should be pointed out that in view of the already difficult problems of Treasury financing this year, it would hardly be practicable or desirable to attempt to absorb through sales of Government securities in the market from the Federal Open Market Account as large an amount of redundant reserves as would be released by the simultaneous action of adding vault cash to reserves and eliminating the central reserve city classification.

As pointed out in statements presented to your Committee, the Board is cognizant of the difficult problems of adjustment that will be involved in permitting vault cash to be counted as reserves. The Board had had in mind making gradual changes over an extended period of time combined with appropriate adjustments in reserve requirements and with perhaps some releases of reserves to meet growing monetary needs. These changes should be effected in such a manner as not to widen unduly existing margins between classes of banks and so as not to interfere with the broader aims of monetary policy.

Passage of the bill in the exact form approved by the Senate Committee would make necessary quicker and more drastic adjustments than

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had been contemplated. The alternative would be the increasing of inequities among banks, as well as serious interference with appropriate monetary policies.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

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