The attached set of minutes of the meeting of the Board of Governors of the Federal Reserve System on May 25, 1959, which you have previously initialed, has been amended at the request of Governor Robertson to modify his comments which appear in the first full paragraph on page 6.

If you approve these minutes as amended, please initial below.

Governor Szymczak

Signature
Minutes for May 25, 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.

Chm. Martin
Gov. Szymczak
Gov. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson
Gov. King
Minutes of the Board of Governors of the Federal Reserve System

on Monday, May 25, 1959. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Fauver, Assistant Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Hill, Assistant to the Secretary

Messrs. Marget, Furth, Hersey, Sammons, Irvine, Katz, Reynolds, and Wood of the Division of International Finance


Economic review. The staffs of the Divisions of International Finance and Research and Statistics presented a review of the international and domestic economic conditions and developments.

All members of the staff except Messrs. Sherman, Riefler, Young, and Hill then withdrew and Messrs. Hackley, General Counsel, Hexter, Assistant General Counsel, and Benner, Assistant Director, and Huning, Review Examiner, Division of Examinations, entered the room.

Consultants for industrial production index revision. There had been circulated to the Board a memorandum from Mr. Noyes dated May 15, 1959, in which it was proposed that a group of authorities from outside Government be invited to act as consultants on various
features of the revision of the industrial production index currently in progress. It was proposed that a panel of six members drawn from at least two broad areas of professional competence, namely, competence in index number methodology and competence resulting from use of the production index and related measures of high level economic analysis, be invited to attend a one-day conference at the Board. Total costs were not expected to exceed $1,600; $900 for consultant costs at the rate of $50 per day for three days for each consultant (allowance was made for time to review specially prepared documentation pertaining to the revision), and travel costs of not more than $700.

In discussing the proposal, Mr. Young stated that the importance of having such a group of consultants stemmed in a large part from the widespread use of the production index as an official measure of performance of the United States economy. The revision would probably result in an increase of about two percentage points in the level of the index and, in view of the wide use of the index, it would be desirable to get the best judgment of authorities in the field as to the setting of the index and the revision. It was noted that no specific provision was made in the 1959 budget for this consultation, but because circumstances have limited certain other planned expenditures, authorization of this proposal would not result in an overexpenditure.
Following a brief discussion, the proposed conference was approved unanimously, with the understanding that expenditures would not exceed approximately $1,600.

Messrs. Riefler and Young then withdrew from the meeting.

The Michigan Bank (Item No. 1). On September 5, 1958, Messrs. Hay, Stoddard, and Alley of The Michigan Bank, Detroit, Michigan, met with the Board to present their views with respect to certain matters, including a condition of membership imposed when the bank was admitted to membership in the Federal Reserve System on April 26, 1956; namely, that "none of the bank's stock shall be held or owned, directly or indirectly, by The Michigan Bank's proposed employees' profit-sharing retirement trust if such trust is established". The examination report of February 10, 1958, prepared by an examiner for the Federal Reserve Bank of Chicago, criticized a purchase on December 31, 1957, of 1,500 shares of the bank's common stock by the trustees as an investment for the profit-sharing trust as a violation of the condition of membership. The member bank defended the purchase on the grounds that the condition of membership applied to its retirement trust, established on April 30, 1956, not to the profit-sharing trust established on March 8, 1956, seven weeks before the subject bank was admitted to membership. The bank also contended that the Board had no statutory power to prescribe such a condition of membership. As a result of a review of the possible
violation, during which the General Counsel of the Chicago Reserve Bank expressed the opinion that the acquisition of the bank's own stock by the profit-sharing plan was not a violation of the condition of membership, the Reserve Bank asked the Board to consider the question. During the conference at the Board's offices on September 5, 1958, representatives of The Michigan Bank indicated that the profit-sharing trust would not acquire more than 10 per cent of the outstanding stock of the bank.

In a memorandum distributed to the Board under date of May 1, 1959, the Division of Examinations recommended that, even though the bank's contentions regarding the validity and applicability of the membership condition were questionable, no action be taken with respect to the enforcement of the condition, at least as long as no more than 10 per cent of the outstanding stock of the bank was acquired by the profit-sharing plan. A letter along these lines to the Federal Reserve Bank of Chicago was submitted for the Board's consideration.

Following a review by Mr. Benner of the basis for the Division of Examinations' recommendation, Mr. Hackley stated that, while the contentions of the bank might be answered, there was some doubt as to the adequacy of the answer. To impose a condition of this type on The Michigan Bank and not on other banks, apart from the legal considerations, was in his opinion inequitable, and failure to enforce the
condition was an indecisive solution. He thought the more desirable solution would be to rescind the condition with the understanding that the plan would not hold more than 10 per cent of the bank's stock.

Mr. Benner expressed the view that the condition was desirable from the standpoint of good banking practice and that, since The Michigan Bank had agreed to the condition in accepting membership, he thought it would be preferable to let the condition stand.

Governor Mills said that he thought the limitation should be removed with respect to the profit-sharing trust. As to the pension trust, he recalled the accounting principle that emergency reserves should not be invested in the business itself because they would thus be subject to the same hazards as the business operation. There was a major distinction between the retirement trust and the profit-sharing trust, he said. The latter was a vehicle for admitting employees into a share of the earnings of the business. Since it had become a custom for profit-sharing funds to be used as a means of distributing to employees a share of the earnings of the business for which they worked, he felt that the Board should examine very closely that question before trespassing on a principle that was used widely throughout industry.

In response to a question from Governor Balderston, Governor Mills went on to say that, while there might be a possibility that a profit-sharing plan would be used as a vehicle by which management of a bank would
perpetuate itself without having to dilute ownership control, Governor Mills said that this was a problem to be reached through the examination procedure and the understandings that were applied to the holdings in trust of the shares of the bank.

Governor Robertson said that he did not subscribe to the proposed letter because it sought to maintain the special condition of membership with no exceptions. As Governor Mills had said, his view was that the Board should definitely take a position with respect to the profit-sharing plan and should clearly state that the condition of membership did not apply. Whether to retain the condition for the retirement trust which had been created after the condition was accepted by the bank was a matter of judgment. In his judgment, Governor Robertson said, such a condition, to be effective, should be made applicable to the trustees, not to the bank, and as pointed out by Mr. Hackley, there was a serious question in his mind as to whether such a condition could be enforced in the courts. His conclusion was that the Board should now act to withdraw the condition completely, at the same time stating to the bank in the letter withdrawing the condition that it was understood that not more than 10 per cent of the bank's common capital stock would be held in the profit-sharing plan. With respect to the retirement trust, the principle was sound that capital stock of the bank should not be an investment of that fund but this should be done
by legislation rather than on a condition of membership. For these reasons he believed the wisest course would be to withdraw the condition entirely.

Governor Szymczak concurred in the view that the special condition of membership be withdrawn in the case of The Michigan Bank, and Governor Mills indicated that this would be agreeable to him.

Mr. Hackley stated that Governor Shepardson had indicated prior to this meeting that he would withdraw the condition of membership under discussion.

It was then agreed that the letter should be revised to reflect the views expressed at this meeting; namely, to rescind the condition but state that the Board understood that none of the preferred stock and not more than 10 per cent of the bank's outstanding common stock would be acquired by the profit-sharing trust and no stock of either class would be acquired by its retirement trust. A copy of the letter sent pursuant to this action is attached hereto as Item No. 1.

The meeting then adjourned.
Board of Directors,
The Michigan Bank,
Detroit, Michigan.

Gentlemen:

This refers to a meeting of representatives of your bank with the Board of Governors on September 5, 1958, in respect to the condition of membership numbered 3 of The Michigan Bank, Detroit, Michigan.

The Board has reviewed the matter and, after taking into consideration all the circumstances, has rescinded said condition of membership. It is the Board's understanding, however, that none of the preferred stock and not more than 10 per cent of the outstanding common stock of the bank will be acquired by its profit-sharing trust and that no stock of either class will be acquired by its retirement trust.

Very truly yours,

Merritt Sherman,
Secretary.