

Minutes for May 29, 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 <u>W</u>	_____
Gov. Szymczak	x <u>MS</u>	_____
Gov. Mills	x <u>[Signature]</u>	_____
Gov. Robertson	x <u>R</u>	_____
Gov. Balderston	_____	x <u>CCB</u>
Gov. Shepardson	x <u>[Signature]</u>	_____
Gov. King	x <u>[Signature]</u>	_____

Minutes of the Board of Governors of the Federal Reserve System
on Friday, May 29, 1959. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. King

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Hackley, General Counsel
Mr. Molony, Special Assistant to the Board
Mr. Shay, Legislative Counsel
Mr. Furth, Associate Adviser, Division of
International Finance
Mr. Hexter, Assistant General Counsel
Mr. Nelson, Assistant Director, Division
of Examinations
Mr. Goodman, Assistant Director, Division
of Examinations
Mr. Benner, Assistant Director, Division
of Examinations
Mr. Young, Assistant Counsel

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:

Letter to the Lincoln Rochester Trust Company,
Rochester, New York, granting an extension of
time to establish a branch at 65 Fitzhugh Street
North. (For transmittal through the Federal
Reserve Bank of New York)

Item No.

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Item No.

Letter to the County Trust Company, Tenafly, New Jersey, granting an extension of time to establish a branch at 1 Union Avenue, Borough of Cresskill. (For transmittal through the Federal Reserve Bank of New York) 2

Letter to Chase International Investment Corporation, New York City, extending for six months the time within which Arcturus Investment & Development, Ltd., Montreal, Canada, may invest an amount not to exceed \$250,000 in stock of a Panamanian corporation. (For transmittal through the Federal Reserve Bank of New York) 3

Messrs. Goodman and Furth then withdrew and Messrs. Young, Director, and Noyes, Adviser, Division of Research and Statistics, entered the room.

Statement on H.R. 6092 and H.R. 6093 (Item No. 4). In a letter dated May 19, 1959, Congressman Brown, Chairman of Subcommittee No. 2 of the House Banking and Currency Committee, invited the Board to submit a statement for inclusion in the record of hearings on H.R. 6092 and H.R. 6093 as an alternative to presenting testimony. These bills contained a number of provisions relating to the "internal" functioning of the banking system created by the National Bank Act and to the supervision of that system by the Comptroller of the Currency. However, they also included some provisions of special interest to the Board of Governors because of their relationship to the field of credit regulation, their applicability to member State banks, or the Board's concern with the soundness of banking operations generally.

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A draft of statement for inclusion in the record of hearings had been distributed to the Board with a memorandum from the Legal Division dated May 27, 1959. The memorandum pointed out that many of the provisions of the bills had been included in the proposed Financial Institutions Act of 1957 at the suggestion of the Comptroller of the Currency, and that most of the provisions were similar to those contained in drafts of bills on which the Board had submitted reports to the Bureau of the Budget within recent months.

The proposed statement would indicate that the Board had no objection to enactment of the two bills except to the extent indicated. With respect to a proposed amendment to Section 5202 of the Revised Statutes contained in H.R. 6092 which would authorize a national bank to borrow up to the amount of its capital stock plus its surplus rather than the amount of its capital stock alone, the statement would suggest the alternative possibility of restricting the borrowing power of each bank to 50 per cent of its capital and surplus. With respect to a proposed amendment to Section 5200 of the Revised Statutes which would allow a national bank to purchase from a dealer, finance company, or other customer unlimited amounts of instalment paper endorsed or guaranteed by such customer, which might include non-negotiable and unsecured paper, question would be raised as to the advisability of the proposal. With respect to proposed amendments to Section 24 of the Federal Reserve Act which would expand the lending powers of

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national banks in the real estate field, doubt would be expressed as to one section which would permit national banks to accept real estate collateral for business loans without subjecting such loans to either the percentage of value limitations or the aggregate limitations of Section 24. With respect to provisions of H.R. 6093 relating to restrictions on the payment of dividends, questions would be raised with regard to the equity of the results achieved and certain suggestions would be made.

Comments by Messrs. Hackley and Hexter brought out that the questions raised in the proposed statement had been confined to matters that were of substantial importance from the viewpoint of sound banking or that affected matters as to which the Board had direct responsibility. Therefore, although certain sections of the proposed bills contained apparent inconsistencies and ambiguities previously called by the Board to the attention of the Comptroller's Office, no reference would be made thereto in the proposed statement. It was also pointed out that many portions of the statement followed closely statements made by the Board several years ago in connection with the proposed Financial Institutions Act.

Mr. Hexter then discussed in more detail those provisions of the bills as to which questions would be raised, and concurrence was expressed with the approach to those provisions taken in the draft statement. Accordingly, suggestions were limited for the most part to changes in emphasis and construction.

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At the conclusion of the discussion, unanimous approval was given to a statement in the form attached as Item No. 4 for transmittal to the Chairman of Subcommittee No. 2 of the House Banking and Currency Committee for inclusion in the record of hearings on H.R. 6092 and H.R. 6093. A copy of the letter transmitting the statement is also attached under Item No. 4.

Messrs. Hexter, Nelson, Benner, Shay, and Walter Young then withdrew.

Consumer survey program for 1960. There had been distributed to the Board a memorandum from Mr. Young, Director of the Division of Research and Statistics, dated May 28, 1959, recommending that in lieu of a survey of consumer finances in 1960 the staff be authorized to undertake methodological research oriented toward a survey in 1961 that would provide improved information on the financial position and transactions of the consumer sector of the economy. In order to facilitate this research, the staff would be authorized to enter into contracts with the University of Michigan, the Bureau of the Census, or other survey organizations in a total amount not to exceed \$75,000 for work to be done during the period from September 1959 through June 1960. Individual contracts under this authorization would be submitted for approval to the member of the Board in charge of internal management affairs. The memorandum noted that the quarterly

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surveys of consumer buying intentions would continue to be carried out through the Bureau of the Census during the remainder of 1959, that the Board might wish to continue those surveys in 1960, and that the question would be presented to the Board for consideration later this year.

At the Board's request, Mr. Noyes reviewed the reasons for the staff recommendations and outlined the nature and purpose of the methodological research proposed to be accomplished.

The recommendations contained in the memorandum of May 28, 1959, then were approved unanimously.

Reserve requirement legislation. Chairman Martin reported receipt of a letter dated May 26, 1959, from Congressman Byron Johnson of Colorado, a member of the House Banking and Currency Committee, with respect to the pending legislation on member bank reserve requirements, and stated that a draft of reply would be distributed for the Board's consideration.

Questions regarding discount rate increase. Chairman Martin reported having received telephone calls from Chairman Robertson of the Senate Banking and Currency Committee with respect to the increase in the discount rate at several Federal Reserve Banks earlier this week. At first, he said, the Senator requested a statement of reasons for his assistance in preparing to speak on the floor of the Senate early next week. However, when Chairman Martin explained why the Board had followed the general practice of not offering immediate

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explanations of System policy actions, Senator Robertson revised his request in such manner as to indicate that he would like to have a statement discussing what would be necessary to the maintenance of an easy money policy under conditions such as existed at the present time.

Chairman Martin said it was his judgment that a memorandum should be furnished to Senator Robertson in compliance with the latter's revised request. Such a memorandum would not set forth the specific reasons for the recent change in the discount rate but instead would cover in general terms the implications of maintaining a pegged interest rate.

After discussion of alternatives, it was the conclusion of the Board that a memorandum should be furnished and that the approach suggested by Chairman Martin would be suitable. Accordingly, the staff was requested to draft such a statement, with the understanding that it would be transmitted to Senator Robertson when in a form acceptable to the Chairman.

The meeting then adjourned.

Secretary's Notes: Governor Shepardson today approved on behalf of the Board the following items:

Memoranda from appropriate individuals concerned recommending the following actions affecting the Board's staff:

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Appointments

Jeannette V. Breden as Assistant Manager, Cafeteria, Division of Administrative Services, with basic annual salary at the rate of \$4,490, effective the date she assumes her duties.

Midge C. Brown as Clerk-Stenographer, Division of Personnel Administration, with basic annual salary at the rate of \$3,755, effective the date she assumes her duties.

Salary increases, effective May 31, 1959

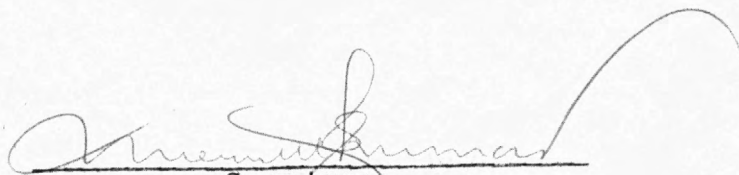
<u>Name and title</u>	<u>Division</u>	<u>Basic annual salary</u>	
		<u>From</u>	<u>To</u>
<u>Office of the Secretary</u>			
Henry B. Hummel, Administrative Assistant		\$5,130	\$5,280
<u>Research and Statistics</u>			
James B. Eckert, Chief, Banking Section		13,670	13,970
Esther P. Locke, Secretary		4,640	4,790
Athens J. Messick, Secretary		5,580	5,730
<u>International Finance</u>			
Betty B. Taylor, Secretary		4,640	4,790
<u>Bank Operations</u>			
Helen M. Bennett, Secretary		4,790	4,940
<u>Examinations</u>			
Anna S. Courtney, Secretary		5,240	5,390
Daniel H. MacDonald, Assistant Federal Reserve Examiner		5,430	5,580
Wm. E. Rumbarger, Assistant Federal Reserve Examiner		6,135	6,285
Ann C. Tompros, Special Assistant Federal Reserve Examiner		4,490	4,640
<u>Administrative Services</u>			
Mary Crawford, Head Cook		4,135	4,230

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Governor Robertson, acting in the absence of Governor Shepardson, today approved on behalf of the Board a letter to the Federal Reserve Bank of San Francisco approving the appointment of William J. Zunkel as assistant examiner. A copy of the letter is attached as Item No. 5.

There was sent today over the signature of Chairman Martin a letter to The Honorable Frederick H. Mueller, Under Secretary of Commerce, designating Mr. Marget, Director of the Division of International Finance, to represent the Board in an interagency study of the competitive position of the United States in relation to the rest of the world.



Secretary

1904

Item No. 1
5/29/59

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD



May 29, 1959

Board of Directors,
Lincoln Rochester Trust Company,
Rochester, New York.

Gentlemen:

The Board of Governors extends to September 19, 1959, the time within which Lincoln Rochester Trust Company, Rochester, New York, may, under the authority contained in the Board's letter of June 19, 1958, establish a branch at 65 Fitzhugh Street North, Rochester, New York.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

1905

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

Item No. 2
5/29/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 29, 1959

Board of Directors,
County Trust Company,
Tenafly, New Jersey.

Gentlemen:

The Board of Governors extends to December 4, 1959, the time within which County Trust Company, Tenafly, New Jersey, may, under the authority contained in the Board's letter of December 4, 1957, establish a branch at 1 Union Avenue, Borough of Cresskill, New Jersey.

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
5/29/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 29, 1959.

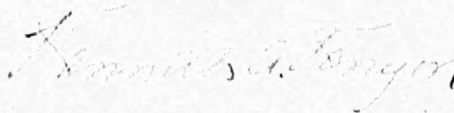
Mr. Webb Wilson, Vice President,
Chase International Investment Corporation,
18 Pine Street,
New York 5, New York.

Dear Sir:

In accordance with the request contained in your letter of May 21, 1959, transmitted through the Federal Reserve Bank of New York, the Board of Governors extends to November 30, 1959, the time within which Arcturus Investment & Development, Ltd., Montreal, Canada, a wholly owned subsidiary of Chase International Investment Corporation, may invest an amount not exceeding \$250,000 in stock of Industrias San Antonio, S. A. (or a newly organized Panamanian corporation, if that proves advisable) and acquire additional shares of such stock (not exceeding 10 per cent of the total outstanding) as compensation for financing to be furnished such corporation without the payment by Arcturus of any purchase price, subject to the understanding stated in the Board's letter dated May 29, 1958.

It is understood that Arcturus has already entered into an Investment Agreement providing for its acquisition of stock and loans, that arrangements for the investment by Arcturus in the Panamanian enterprise are progressing satisfactorily, and that you anticipate the investment in stock will be made within a relatively short time.

Very truly yours,



Kenneth A. Kenyon,
Assistant Secretary.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

1907

Item No. 4
5/29/59

OFFICE OF THE CHAIRMAN

June 1, 1959

The Honorable Paul Brown,
Chairman, Subcommittee No. 2,
Committee on Banking and Currency,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

Your letter of May 19 invited the Board to submit a statement on H. R. 6092 and H. R. 6093 for inclusion in the record of your Subcommittee's hearings on those bills. We are transmitting herewith twenty-five copies of the Statement of the Board of Governors on this proposed legislation.

Sincerely yours,

Wm. McC. Martin, Jr.

Enclosures

STATEMENT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WITH RESPECT TO H. R. 6092 AND H. R. 6093, 86TH CONGRESS

H. R. 6092 and H. R. 6093 contain a number of provisions that relate to the "internal" functioning of the banking system created by the National Bank Act and to the supervision of that system by the Comptroller of the Currency; an example is the provision of H. R. 6092 that would increase the number of Deputy Comptrollers of the Currency from three to five. Comptroller of the Currency Ray M. Gidney has urged the enactment of these provisions, and the Board of Governors has no comment to make with respect to the provisions of this nature included in the two bills.

However, the bills also include provisions that are of special interest to the Board of Governors because of their relationship to the field of credit regulation, which is the Board's major responsibility, or because they are applicable to member State banks, which are supervised by the Federal Reserve System, or because of the Board's concern with the soundness of banking operations generally.

Except to the extent indicated herein, the Board does not oppose enactment of the two bills.

H. R. 6092

Limitation on borrowing by national banks. - Section 2 of H. R. 6092 would amend section 5202 of the Revised Statutes (12 U.S.C. 82). At present section 5202 forbids a national bank to be indebted at any time to an amount exceeding the amount of its capital stock.

However, this limitation does not apply to certain categories of obligations, including liabilities incurred under the provisions of the Federal Reserve Act.

The Board is aware that the limit prescribed by section 5202--the amount of the particular bank's capital stock--may produce inequitable differences in the borrowing powers of competing banks. For example, each of two banks might have a capital structure of \$5 million, but one might have \$1 million of capital and \$4 million of surplus and undivided profits, whereas the other might have \$3 million of capital and \$2 million of surplus and undivided profits. In such a situation, the latter bank could legally borrow three times as much as the former (\$3 million as compared with \$1 million), even though their effective capital structures are substantially equal. Such inequities result from the fact that section 5202 refers solely to "capital stock" and disregards the other elements of a national bank's capital structure. It should be noted, however, that a national bank with a relatively large surplus account can increase its borrowing limit by an increase of its capital stock.

The proposed amendment would amend section 5202 to authorize a national bank to borrow up to the amount of its capital stock plus its surplus. The surplus accounts of all national banks aggregate almost \$5 billion, so that this proposal would add that amount to their potential borrowing--and lending--capacity.

This considerable expansion in the borrowing ability of national banks would, in the Board's opinion, be unnecessary and undesirable. Although bank borrowings may occasionally be necessary

in limited amounts and for limited periods in order to avoid liquidation of assets that might otherwise be necessary, it is a practice that should not be encouraged because it tends to dilute the cushion of protection which is afforded depositors by a bank's capital and surplus. Enlargement of the borrowing limits as here proposed might well encourage national banks to hold smaller amounts of liquid assets and to rely unduly upon borrowings for necessary adjustments. In the case of an emergency requiring unusual borrowing, the discount facilities of the Reserve Banks are available. To encourage the ability of national banks to borrow outside the Reserve Banks would tend to diminish the restraining influence that the Reserve Banks are directed by law to exert upon borrowing member banks which may be making undue use of credit for speculative purposes.

It is possible that any inequities inherent in the present section 5202 could be diminished without greatly expanding the aggregate borrowing power of national banks and thereby affecting adversely the existing salutary restriction on the volume of inter-bank borrowing. One possibility would be to base the limitation on national banks' borrowing authority on the amount of capital stock plus surplus, as recommended by section 2 of H. R. 6092, but to restrict the borrowing power of each bank to 50 per cent of its capital stock and surplus. The Board recognizes that such an amendment would reduce the amount that could be borrowed by a national bank with a surplus that is less than the amount of its capital stock, but it is believed that this would not be injurious or unjust.

Loans on guaranteed installment consumer paper. - Section 3(d)

of H. R. 6092 would add a new paragraph (13) to section 5200 of the Revised Statutes (12 U.S.C. 84), which prescribes limitations on the amounts that a national bank may advance to any one borrower. A proviso to this new paragraph would permit a national bank to make unlimited advances to the endorser or guarantor of installment consumer paper, if

- (1) an officer of the bank certifies in writing "that the responsibility of each maker of such obligations has been evaluated and the [bank] is relying primarily upon each such maker" rather than upon the endorser or guarantor, and
- (2) "the bank's files or the knowledge of its officers of the financial condition of each maker of such obligations is reasonably adequate."

Under this proviso, a national bank could purchase from a dealer, finance company, or other customer, unlimited amounts of installment paper endorsed or guaranteed by such customer. The paper could be nonnegotiable and unsecured, thereby lacking the protection that is afforded the holder of paper that is negotiable or secured. The only requirements would be (1) the above-mentioned certification by a bank officer and (2) that "the knowledge of [the bank's] officers of the financial condition of each maker of such obligations is reasonably adequate."

The Board of Governors questions the advisability of this proposal. The limitations of R. S. 5200 are designed to restrict by law the extent to which a national bank may indulge in unsound and dangerous lending practices. These limitations are unnecessary with

respect to a well-run bank; their function is to place an absolute legal limit on any tendency of a less well-run bank to lend excessively to particular customers and thereby to incur risks that might jeopardize its solvency or its continued operation. Under the proviso, such a bank could make unlimited advances to a single customer, provided only that an officer of the bank signed a statement that "The responsibility of each maker of these obligations has been evaluated and the association is relying primarily upon each such maker for the payment of such obligations." In these circumstances, the certification requirement might not constitute an effective impediment to unlimited dealer financing of this character.

For the reasons indicated, the Board questions the desirability of the proviso in the proposed new paragraph (13) of R. S. 5200.

Loans on real estate security. - Section 4 of H. R. 6092 would amend in a number of respects section 24 of the Federal Reserve Act (12 U.S.C. 371), relating to loans by national banks on the security of real estate. All of these proposed amendments would expand the lending powers of national banks in the real estate field. It should be noted that the general tendency of amendments to section 24 in recent years has been substantially to increase national banks' holdings of real estate loans, and a large volume of such investments is not subject to the aggregate limitations on such loans. Nevertheless, most of the proposed amendments appear to be justified, in view of the improvement in banks' real estate lending practices during the past twenty-five years.

However, the Board of Governors is doubtful with respect to the advisability of section 4(d) of H. R. 6092, which would permit national banks to accept real estate security for business loans without subjecting such loans to either the percentage-of-value limitations or the aggregate limitations of section 24.

This is a major departure from a basic principle of banking. It could lead to a tendency to consider all business loans supported by real estate security as loans based on the general credit of the borrowers, thereby giving rise to a substantial expansion of loans secured by real estate and yet not subject to either the specific or general limitations of section 24 with respect to real estate loans. Such business loans normally are large in amount, and a substantial volume of such illiquid loans could develop free from the protective restrictions of section 24 and without public knowledge, since such loans would not be classified as real estate loans in national banks' reports of condition.

H. R. 6093

Most of the sections of H. R. 6093 appear to be peculiarly within the scope of operations of the national bank system and to have no material significance insofar as the functions and responsibilities of the Federal Reserve System are concerned.

It is observed that many of the provisions in the proposed legislation relating to national banks appear to be desirable due to changes in practice or in other legislation.

Obsolete references in existing law would be eliminated, including those concerned with government agencies and corporations formed pursuant to Federal statutes which are no longer active, i.e., Reconstruction Finance Corporation, Home Owners' Loan Corporation and National Agricultural Credit Corporations. Other obsolete provisions include those which relate to installment payments on capital stock of national banks and liability of shareholders of national banks for debts of the bank. The Board considers it desirable to eliminate these references since they serve no useful purpose and tend to mislead and confuse the reader.

The Board would have no objection or comment with respect to certain other provisions of the bill which appear to be concerned only with the operation of the Office of the Comptroller of the Currency. These include section 3, which would require the approval of the Comptroller before a national bank may move its main office within its own city limits; sections 2 and 4, requiring that all capital stock of a national bank be paid in before it may commence business; section 9, relating to the time of shareholders' meetings; section 12, relating to the time for filing reports of condition of national banks; section 14, establishing the procedures for amending the articles of association of national banks; section 16, which adds a new requirement of a two-thirds vote of shareholders if liquidation of a national bank involves the sale of its assets to another bank; section 19, which makes certain changes in the details of procedures

for winding up the affairs of a national bank; section 21, relating to consolidations and mergers involving national banks; and section 23, relating to reports to the Comptroller of dividends paid by national banks.

It is noted that section 7 would repeal section 23 of the Federal Reserve Act. This repeal is desirable; the provision has been obsolete since the elimination of the individual liability of shareholders of national banks.

Restrictions on payment of dividends. - Section 22(a) of H. R. 6093 would amend the second sentence of section 5204 of the Revised Statutes (12 U.S.C. 56). That sentence now provides that

"If losses have at any time been sustained by any [national banking] association, equal to or exceeding its undivided profits then on hand, no dividend shall be made; and no dividend shall ever be made by any association, while it continues its banking operations, to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts."

Admittedly, this provision is unsatisfactory, in part because of uncertainty regarding the coverage of the expressions "undivided profits then on hand" and "net profits then on hand".

In lieu of the quoted sentence, section 22(a) would substitute the following sentence:

"No dividend shall be paid by any such association while it continues its banking operations if all bad debts due it and all losses sustained are greater than the amount of any surplus funds in excess of its common capital, plus its undivided profits and reserves."

Presumably the purpose of the proposed new sentence is to give greater freedom, with respect to dividends, to a national bank that has built up its surplus account until that account exceeds the amount of its capital stock. However, it appears that the effect of the provision, in some situations, would be to favor banks that retained earnings in "junior" capital accounts over banks that tended to transfer their accumulated earnings into "senior" capital accounts, even though the latter practice, in general, is favored by the Federal bank supervisory agencies.

The following examples may illustrate the problems presented by the proposal:

	<u>Bank A</u>	<u>Bank B</u>	<u>Bank C</u>	<u>Bank D</u>
Capital	\$1,000,000	\$1,000,000	\$1,000,000	\$2,000,000
Surplus	400,000	800,000	1,400,000	1,800,000
Undivided Profits	300,000	100,000	100,000	200,000
Total Capital Accounts	<u>\$1,700,000</u>	<u>\$1,900,000</u>	<u>\$2,500,000</u>	<u>\$4,000,000</u>

Let us assume that each of these banks has losses and bad debts totaling \$200,000.

With respect to Bank A and Bank B, let us assume that each of these banks began business with capital stock of \$1,000,000 and surplus of \$200,000. Bank B has been more profitable, has retained a greater amount of earnings to strengthen its capital position, and has transferred greater amounts from its undivided profits account to its surplus account, than has Bank A. Nevertheless, under the proposed formula, Bank A could legally pay dividends up to \$100,000, whereas Bank B would be prohibited from paying any dividends whatever.

Similarly, it may be assumed that Bank D, by payment of stock dividends, has doubled its original capital stock, and it has transferred much of its remaining accumulated earnings to its surplus account. Bank C, on the other hand, has operated much less profitably, has never increased its capital stock, and has retained in its capital structure less than half as much in accumulated earnings, as has Bank D. Nevertheless, under the suggested formula Bank C could declare dividends of as much as \$300,000, whereas Bank D, with a superior earnings record and a stronger financial structure in all respects, would be legally prohibited from declaring any dividend.

The foregoing examples suggest that the proposed new sentence in R. S. 5204 would produce inequitable results in some situations. Such inequity may be inherent in any arrangement that restricts dividends, a phase of operating results, on the basis of the relative size of the several parts of the bank's capital structure.

In this connection, the Board notes that section 22(b) of H. R. 6093 would amend section 5199 of the Revised Statutes (12 U.S.C. 60) by prohibiting (except upon supervisory approval) payment of dividends in excess of a national bank's net profits for the current year plus retained net profits of the preceding two years. In the judgment of the Board, this is a sound and workable limitation based on an appropriate criterion--the recent earnings record of the bank. The Board is inclined to believe that, if this proposal is adopted by Congress, neither the present nor the proposed limitation in section 5204 will be necessary.

This matter is of direct concern to the Federal Reserve System because section 9 of the Federal Reserve Act (12 U.S.C. 324) requires all State-chartered banks that are members of the Federal Reserve System to conform, inter alia, "to those provisions of law imposed on national banks...which relate to the payment of unearned dividends." The broad purpose of this provision is to subject member State banks to restrictions that parallel those applicable to national banks with respect to the extent to which dividends may be paid from the particular bank's capital accounts. The proposed changes in both R. S. 5204 and R. S. 5199 introduce restrictive criteria with respect to payment of dividends that are not strictly matters of "unearned dividends". In the circumstances, if either proposed amendment, or both, are enacted, possible uncertainty as to the effect of the relevant provision of the Federal Reserve Act should be averted by requiring member State banks "to conform to the provisions of section 5204 [or section 5199(b), or both, as the case may be] of the Revised Statutes with respect to the payment of dividends." It should also be made clear that, in the case of member State banks, the supervisory approval referred to in the proposed section 5199(b) is that of the Board of Governors and not the Comptroller of the Currency.

May 29, 1959

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

1019



Item No. 5
5/29/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 29, 1959

AIR MAIL
CONFIDENTIAL (F.R.)

Mr. Eliot J. Swan, First Vice President,
Federal Reserve Bank of San Francisco,
San Francisco 20, California.

Dear Mr. Swan:

In accordance with the request contained in your letter of May 22, 1959, the Board approves the appointment of William J. Zunkel as an assistant examiner for the Federal Reserve Bank of San Francisco. Please advise as to the date on which the appointment is made effective.

It is noted that Mr. Zunkel owns seven shares of stock in Brenton Companies, Des Moines, Iowa, a bank holding company registered under the Bank Holding Company Act of 1956, and also a "holding company affiliate" under the Banking Act of 1933, by virtue of its control of National Bank of Des Moines and South Des Moines National Bank, both of Des Moines, Iowa. Accordingly, the Board's approval of the appointment of Mr. Zunkel is given with the understanding that he will not participate in any examination of any bank or other organization in the Brenton Companies group so long as he is a stockholder in that organization.

Very truly yours,

A handwritten signature in cursive script that reads "Kenneth A. Kenyon".

Kenneth A. Kenyon,
Assistant Secretary.