FR 609 Rev. 10/59

Minutes for December 17, 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, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only 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 Thursday, December 17, 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. King

Mr. Sherman, Secretary

Mr. Riefler, Assistant to the Chairman Mr. Thomas, Economic Adviser to the Board

Mr. Shay, Legislative Counsel

Mr. Molony, Assistant to the Board

Mr. Fauver, Assistant to the Board

Mr. Young, Director, Division of Research and Statistics

Mr. Hackley, General Counsel

Mr. Farrell, Director, Division of Bank Operations

Mr. Solomon, Director, Division of Examinations

Mr. Connell, Controller

Mr. Bass, Assistant Controller

Mr. Hostrup, Assistant Director, Division of Examinations

Mr. Nelson, Assistant Director, Division of Examinations

Mr. Landry, Assistant to the Secretary

Messrs. Herz and Drake of Price Waterhouse & Co.

Reserve Bank capital accounts. Pursuant to the understanding at the meeting on December 7, 1959, Chairman Martin had arranged with Mr. Herz, Resident Partner of Price Waterhouse & Co., to review the accounting practices of the Federal Reserve Banks with respect to capital accounts, particularly as to the need from the accounting standpoint for contingency and depreciation reserves. Mr. Herz, accompanied by Mr. Drake, Manager of the Washington office of Price Waterhouse & Co., was present

for the purpose of presenting to the Board the results of his review.

At Chairman Martin's request Mr. Herz made a statement substantially as follows:

There are really four things that come under the questions that you have addressed to me: first, paid-in capital; second, accumulation of earnings; third, contingency reserves; and fourth, depreciation reserves. Actually, only the latter two items are ones in which we have especial competence by reason of our training. On the question of what should be the relationship between accumulation of earnings and paid-in capital we have no particular competence. I would like to address myself, therefore, to the latter two questions, namely, the reserves for contingencies and the reserves for depreciation.

The reserves for contingencies, we understand, deal to a considerable extent with contingencies that might occur in connection with a loss of currency in transit, registered mail insurance, etc. The experience of the System has been that these losses have not over the years accumulated to a figure anywhere near as great as the amount that has been set aside in the contingency reserves. As I understand the background, the contingency reserve for registered mail losses has built up more or less in accordance with an arrangement under the loss-sharing agreement and if there should be a loss the Banks Would deal with it out of that reserve and in accordance with the agreement. As I see it, there could be a loss-sharing agreement without placing a separate part of capital into a contingency reserve.

The way we feel, and I think this is true of the profession generally, is that a reserve of this type should be provided against earnings only if the contingency can be fairly well measured and if it is fairly imminent. If it is a contingency that does not have a high degree of imminence, one which cannot be measured fairly well, or if it is difficult to specify as to nature, then we feel there should not be a charge against earnings. If, notwithstanding this view, there is a disposition to have such a reserve, then I would suggest that there be set apart a portion of accumulated earnings without making a charge for any particular period. In the latter event it would be a segregation of a portion of the capital, but it would continue

to be capitalization although segregated and although characterized by a presumption that it might leave the System by Way of a contingency.

The other way of having a reserve is by way of a charge against earnings and in that event the implication is that that reserve does not comprise a part of capital. In your case, the nature of this contingency and your experience has been such that you have a portion of the capital that has been separated, but you do not have a conception that really means that that capital has left the System. Therefore, I would suggest that you would do just as well not to account for contingency reserves in the manner in which you are accounting for them, namely, by making a charge against any particular period and setting up a reserve.

If you ask me whether I think the System should segregate a part of its capital to meet such contingencies, I would say only if you feel there is a strong possibility that there might in a single period be a charge for a catastrophic loss more or less equal to the amount you are setting aside. I gather that is not the situation. Therefore, generally speaking, I would recommend against the contingency reserve and the contingency accounting.

Chairman Martin stated that the meeting was now open for discussion of the contingency reserve.

Governor Shepardson noted that Mr. Herz had mentioned specifically the registered mail contingency reserve, and he noted that there were two funds, one applying to registered mail losses, and the other a more general fund.

Mr. Herz responded that he felt he was talking about both of the contingency reserves. What he had said specifically referred more to the registered mail losses than to the other. However, if the contingency for Which a reserve was established was of a more general nature, then the arguments that he had made applied even more strongly to that reserve.

Governor Robertson noted that one of the alternatives that Mr. Herz had mentioned was to earmark a portion of the capital funds as a reserve for contingencies and to have the amount in relationship to the contingency that might occur, say \$1 million or \$5 million or some other amount. He wondered how capital funds could be earmarked so as to avoid giving the impression that the fund was for an actual loss, but was rather a fund set up to meet only a possible loss.

Mr. Herz said that this could be done by separating the accumulated earnings into two figures, a figure of accumulated earnings and one that would be identified for a specific purpose.

Governor Mills said that this meant a segregation of the surplus account where a section was earmarked to a reserve, but the complete surplus should then be regarded as a general protection to the Federal Reserve Banks with a segment to be absorbed in risks for which the segregation was made.

Mr. Herz said that the other way this could be done would be not to divide the account, but to indicate in the narrative referring to the statement that it was the intention of the Board to regard a portion of the accumulated earnings as being committed to the specific contingency that it had in mind. This was a little less forceful way of putting it, but perhaps equally satisfactory. In response to a question from Mr. Thomas, Mr. Herz went on to say that in the event of a loss of the sort mentioned, a charge would be made against past accumulated earnings,

not against current earnings. This would make a difference in the payment that would be made to the Treasury which was calculated on current earnings.

Mr. Farrell said that he gathered from Mr. Herz' remarks that if it were now a matter to be decided, he (Mr. Herz) would rule out setting aside the \$80 million reserve for contingencies that had been set up by withholding earnings from the amounts on which interest was paid to the Treasury.

Mr. Herz responded that this was correct. As to whether the contingency should be a tax deduction or a payment to the Treasury, it seemed to him that within the discretion of the Reserve Board, the charge could be made in whatever manner the Board desired. Mr. Thomas commented that the point was that if interest had already been paid to the Treasury on earnings of the Reserve Banks at one time, it should not be paid again. He understood the accounting practices would permit the Board to use discretion as to when the earnings were treated for interest payments to the Treasury.

Mr. Farrell noted that the interest payment had been technically ruled to be an expense for the current year and that the payment could not be made under the accounting concept in any other manner.

Mr. Herz commented that when the annual payments to the Treasury Were discussed in this way, one got into the realm of semantics and into a no man's land. The System was dealing with this as though it were

interest, but in fact it was not interest. It was more nearly like an income tax--certainly much more like the income tax than interest on indebtedness if it were considered in the concept of a private organization. In response to a question from Governor Shepardson, he said he felt he had perhaps not made his position entirely clear. He would not provide for a reserve for contingencies at all. He would not have a contingency reserve whether provided by earnings or a segregation of capital. He would absorb the impact of a loss, when and if it occurred, as a charge against the earnings of the period in which the loss occurred, Whether it be an ordinary charge or an extraordinary charge. Even an extraordinary charge in the annual earnings of the Federal Reserve Banks combined was not a highly material element. So long as the Reserve System had a loss-sharing arrangement, the amount of even a relatively large loss in a period should not have a large effect on any Reserve Bank. Therefore, he would deal with it only when such a loss arose. Doing that would put it more in the category of an income tax deduction. In response to a comment by Governor Mills that this would mean that the Treasury was absorbing the loss that might occur in any given year, Mr. Herz commented that any way the matter was handled, an amount equal to 90 per cent of the loss or the charge against the real contingency was going to be withheld from the Treasury sooner or later.

Chairman Martin then suggested that the discussion turn to the question of depreciation on plant and buildings.

Mr. Herz said that his approach to this subject was based on the earnings statement rather than on the balance sheet. In the accounting profession there had been a transition over the years. Thirty years ago the balance sheet was the approach that got first attention. Now the thinking was about the earnings statement and not so much about the balance sheet.

Governor Balderston interjected at this point that this seemed to be the heart of the question the Board was discussing. The System's Portfolio of securities running to around \$26 billion was well supplied With short-term securities. So long as the System stuck to a policy of trading in bills usually it was not likely to experience heavy losses from the sale of securities dictated by policy considerations even though the current value of the portfolio computed on market figures might drop below the figure shown in the statement. He wondered, however, in the event there should be a great drop in the value of securities as measured by the market, which would imply large potential losses, in that event Would Mr. Herz still take the same view as to the usefulness of a reserve for contingencies.

Mr. Herz said that up to this point he had not given a great deal of thought to the earnings statement of the Federal Reserve Banks as an accounting matter. He had thought some about it and his partners had studied the question to some extent. They would be glad to give further consideration to this aspect. However, the whole concept of the earnings

statement in private business was that the corporation shall not drain its assets away from its creditors. This was not as prominent in considering the Federal Reserve's statement as it was with a private corporation. In a private corporation, it was extremely important because the purpose of the private corporation was to make earnings. The Federal Reserve's annual earnings statement was less important from the standpoint of maximizing earnings than from the standpoint of displaying all of the activities of the Federal Reserve System and what the results had been in pursuit of its function. If the financial condition of the System took a turn such as that suggested by Governor Balderston through some catastrophic loss of its assets, it would be much better in his judgment for the statement for the Federal Reserve for that year to show What had happened rather than to conceal it. It would be better that it be shown for that year than to have provided for the loss in some prior years when no such loss occurred. The fact that the loss did occur in a given year was an extremely important piece of information from the standpoint of the activities of the Federal Reserve and its function. The statement was much more important as a statement of activities for the central bank than it was as a statement of earnings in any given year. Mr. Herz said that it occurred to him that there was something to be said for not anticipating such losses but for taking care of them in the year in which they happened to occur. This was because they represented an important part of the activities in which the Federal

Reserve had engaged in that year, and he thought that this was something that the System should be talking about.

Governor Robertson inquired of Governor Balderston as to how he would charge an actual loss of the type he had described, to which Governor Balderston responded that he agreed with the approach taken by Mr. Herz. He had wanted, however, by his question to Mr. Herz, to confirm the fact that with a portfolio of \$26 billion, if a loss of the type he had described were to occur, Mr. Herz' view would still be the same as that he had expressed before. He gathered this to be the case.

Governor Robertson said that he, too, gathered this to be the case. However, he wondered what would be the effect if such a loss occurred and it exceeded the amount of capital and surplus of the Federal Reserve Banks. Would Mr. Herz show this as a deficit?

Mr. Herz stated that you would have a deficit and this should be shown. This would be a germane event to the position of the Federal Reserve in that year. If it could be described accurately in financial terms, this was a manifestation of activities that should be disclosed.

Governor Robertson noted that if this happened to a private bank the bank would be closed because of impairment of its capital.

Chairman Martin commented that this was true but that it also marked the difference between the Federal Reserve and a private bank.

This was part of the difference in accounting procedures to be followed.

A Federal Reserve Bank would not be closed for this reason.

Governor Robertson agreed with this view stating, however, that it all came down to the point that the contingency reserve about which we were talking was just one segregation of capital and surplus, that the whole of the Federal Reserve's capital and surplus and undivided profits was available for use in any way that might be called upon for capital account. When Mr. Thomas commented that this was true of private banks similarly, Governor Robertson concurred and stated that this emphasized the reason in analyzing a private bank's capital position for considering its entire capital funds, not just the amount labeled as capital.

In response to a question from Governor King as to whether he would agree with the total capital concept, Mr. Herz responded in the affirmative. He said that he did not know how to measure the accumulation of earnings against capital and that he did not think the need was measured by how large the paid-in capital of the Reserve Banks was. It was on the other side. The question was: What is the policy with respect to the long- and short-term securities in the System Account and what was the need for protection against possible losses? The convenience of stating earnings in terms of paid-in capital was conventional but it was not the measure of the need in the case of the Federal Reserve System.

In response to a question from Governor Robertson as to whether the Federal Reserve Banks needed to have capital and surplus accounts, Mr. Herz responded that he did not know, that he thought this was a question that depended upon the point of view of an individual.

Mr. Solomon suggested that the analysis of reserves as between commercial banks and the Federal Reserve might be broken down in two steps: first, a comparison of how much each felt it should be protected by way of capital and surplus against unforeseen developments and, second, to what extent was there a difference between the treatment to be given to commercial banks and to be given to the Federal Reserve in their respective statements because of the Government guarantee of Federal Reserve notes, one of the principal liabilities of the Federal Reserve.

Mr. Herz said that he did not know how to compare the Federal Reserve Banks with the commercial banks as far as capital needs were concerned. The Federal Reserve Bank is an arm of Government. The commercial bank has relatively narrower responsibilities than the Federal Reserve. Also, the contingencies faced by the Federal Reserve are such as to make its position different from year to year.

Mr. Herz then turned to the question of depreciation reserves, making a statement on that subject substantially as follows:

My initial approach to depreciation reserves has tended to be very much like my approach to contingency reserves. My feeling has been that depreciation is a very unimportant thing in the Federal Reserve, that it does not have much bearing on your earnings or on your capital. Some of my partners have a little different feeling. We approach this again against the earnings statement rather than the balance sheet. I feel this way more after talking with my partners than before. The Federal Reserve, when it considers depreciation, should perhaps bear in mind that whatever it might do with reference to depreciation should be looked upon as setting an example. If you should decide not to do any more property depreciation, that might have an undesirable effect

on other people. The conception of depreciation has been changed over the years. At one time, when costs were fairly stable, there was a different thinking. It was the inevitable march to the junk pile that they recognized, but, as you know, depreciation has been seized on by many people including legislative bodies as a means of giving many people a tax break that someone else does not get. It has even been suggested that small business should be given a chance to take depreciation two or three times to get a good tax break. But all of those things come to about this: This System has a considerable investment in its plant, something like \$200 million. This plant is depreciating. With the passage of time, its utility diminishes, and with the passage of time some of it will have lost its utility. Consequently, any annual statement of earnings and costs should carry in it an element of cost for the use of these premises which the System owns and in which it conducts its affairs. That is the essence of depreciation. So, we feel that this annual earnings statement should contain an annual depreciation charge since that is due for the property and its use. We think perhaps that this should be calculated in accordance with convention. is, the costs (or sometimes another measure of value at a particular point of time) should be the basis for that annual charge and the charge should be determined by prorating the costs over a period of time estimated to be the useful life of that property. When one gets into property accounting, he immediately encounters a great many complications; for example, does replacement of a roof enhance the value of the property? You run into endless problems of small decision. In a case like that of the Federal Reserve where depreciation is not an element of grave importance, all of these details are not worth the effort needed to make the fine distinctions. Consequently, We would suggest that (a) the Federal Reserve have in its annual statement a depreciation charge, (b) the charge be calculated according to depreciation convention, and (c) the Federal Reserve consider the problem of accounting and reduce it to as simple a basis as possible, that is, eliminate as many as possible of the day-to-day small decisions that have to be made. Such a procedure as that might even bring you to the point of adopting certain conventions for distinguishing between what you will capitalize and what you will charge off for expense Which might differ from business enterprise. But that would not drop the basic depreciation concept. It would be a practical adjustment in the procedure to cut down on costs,

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useless expenditure of effort, and detailed accounting. Essentially, I would recommend that the Federal Reserve aim for maximum simplification. In summary, we would recommend that you show depreciation in your statement no matter how small, and that you bring in the maximum simplification.

In response to a question from Governor Mills as to building and equipment, Mr. Herz said that buildings of the Federal Reserve at present Were capitalized and equipment was expensed. Depending upon how the Word "equipment" might be used, he would say that this distinction was generally satisfactory. However, it was difficult to distinguish between What was building and what was equipment, and there was a great deal of building equipment about which decisions would have to be made. He would think it desirable to reconsider the nature of what the property of the System was and perhaps the definitions of some of these items. In general, he would continue to capitalize buildings and to charge off equipment, but he would make a distinction with all equipment as to Whether it belonged in buildings or not.

Governor Robertson stated that he thought he agreed with this comment in general. However, he wondered just how this would be done. If you expense such items as furniture, that seemed to present no problem. If, however, the System were to invest in a costly computer, should that not be capitalized?

Mr. Herz said that he would answer this question in the affirmative, but that on some items of equipment he would want to consider them more carefully. In general, he would expense equipment and capitalize

buildings. He agreed with the comment by Governor Robertson that the idea of simplification would include expensing as many items as possible. In this way, the expense account would get a charge for the use of the facilities and also for equipment replacements, for new equipment, for maintenance of equipment, and equipment rentals, and all of those things that could be lumped together as costs of equipment that need not be capitalized. There should not be any distortions of the accounts by reason of such decisions.

In response to a question from Governor Shepardson as to how the cost of a new roof might be treated, Mr. Herz responded that once the system under discussion was well established as to what in general would be capitalized and what in general would be expensed, he thought it would turn out that replacement of a roof or repairs to a roof or other repairs of that sort would be expensed.

Governor King said that he was in favor of an approach such as that outlined by Mr. Herz. He thought, however, that in the case of an expenditure for a roof, the amount could be capitalized relatively simply and then depreciated over the remaining life of the building. He thought this would represent a relatively simple adjustment.

Mr. Herz said that property accounting tended to complicate itself, and he mentioned public utilities as examples of such complications. He then referred to the fact that the head office building of the Federal Reserve Bank of New York would have been, under the present procedure,

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completely depreciated by the year 1966, and that in 1967 earnings of the New York Reserve Bank would not show any charge to depreciation, although the Bank would have the use of a very good building. On that basis, the earnings statement of the Bank, according to the approach he had taken, was going to be very misleading for that particular year. For reasons like that, the System might decide that it would like to incorporate into any revision of its depreciation accounting procedures a means for taking care of such situations as the one he cited at the New York Reserve Bank. The depreciation convention is not for the purpose of enabling an institution to replace its plant—you do not provide for replacement of plant through depreciation. There are many other things that bear on the replacement of plant. For example, for a large part of private business, obsolescense has become a great deal more important than the march to the junk pile.

Governor Balderston stated that he understood Mr. Herz' comments to be saying that there was no rational reason for the Federal Reserve System to include depreciation in its statement of expenses, that the fundamental reason for doing so was the public relations one of retaining the confidence in the integrity of the expenses and earnings, and of setting a good example for private industry where property accounting is important. To illustrate this, he noted that the Federal Reserve had no pricing problem and, therefore, it does not need a correct cost to include the proper amount for depreciation. It does not have any

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Federal income tax to pay. It does not have to aim for funds for dividends because the dividend is set by statute. The three end-purposes to be served by proper accounting for depreciation by a private industry firm thus do not apply to the Federal Reserve, Governor Balderston said, nor had he heard of any arguments that the operations of the Federal Reserve would be made more efficient because of depreciation. Thus, he would assume that the Federal Reserve had no rational basis for including depreciation, and depreciation would yield no result for the System; nevertheless, there is the problem of setting a good example for others and of providing in the annual statement a statement that shows earnings, Bank by Bank, that would not be subject to question, since the public relations angle for the System was dominant.

Mr. Herz said that the answer to what Governor Balderston was saying would be "yes." He was merely recommending that the System "conform." He could not say that there had been any other practical effect for the System and, therefore, his recommendation was that the System conform even though there was no practical worth to the System other than to refrain from setting an example that might be detrimental elsewhere. To sum up and to put it another way, he would quote from a remark attributed to Lord Chesterfield: "If it is not necessary to change, it is necessary not to change."

Governor Robertson said that to him it was extremely important that whatever the System did in the way of changing its depreciation $\frac{1}{2}$

accounting be supported by a rationale that could be explained to anyone. It should be uniform; it should not be hit or miss. If the System were to change in accordance with the recommendation that Mr. Herz had made, he wondered whether Mr. Herz would give a supporting statement showing the reasons for those changes and why they were in accord with good accounting practice.

Mr. Herz responded that this would mean an affirmative reason, a good accounting reason. He thought that the System should have such a statement, and he could and would be glad to prepare it.

Governor King stated that in reality the depreciation matter became difficult because it involved the individual's philosophy of the System's place in Government. Mr. Herz stated that he thought this no doubt was so, that you had private property and public property, and that it became difficult to know just what the exact place for the System should be.

Messrs. Herz and Drake withdrew from the meeting at this point, as did Mr. Thomas.

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

Item No.

Letter to Commerce Bank & Trust Company, Helena, Montana, approving an investment in bank premises.

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	Item No.
Letter to the Federal Reserve Bank of Boston expressing the view that section 32 of the Banking	2
Act of 1933 would not prohibit directors and officers of participating member banks from serving as directors and officers of a mutual trust investment fund to be known as Bank Fiduciary Fund of Maine.	
Letter to the Presidents of all Federal Reserve Banks regarding additional information to be included in bank holding company applications.	3

Messrs. Riefler and Young withdrew from the meeting at this point and Messrs. Hexter and Chase, Assistant General Counsel, and Miss Hart, Assistant Counsel, entered the room.

Assessment on Reserve Banks for first half of 1960. There had been distributed a memorandum from the Office of the Controller dated December 16, 1959, regarding the assessment to be levied upon the Federal Reserve Banks for Board expenses for the first half of 1960. This memorandum showed that approximately \$3,089,500 would be needed for estimated expenses of the Board for the period indicated, and it was recommended that an assessment of .00232 of the total paid-in capital and surplus of the Federal Reserve Banks as of December 31, 1959, be levied upon the Banks. It was estimated that the foregoing rate would produce a total of \$3,086,115.

Governor Mills inquired whether the assessment figure was based on a revised budget that excluded the items that had been discussed at the meeting of the Board on December 14 when the budget was approved. His impression was that the figure of \$7,035,618 shown in the Controller's

memorandum was larger than was contemplated when the Board gave its approval to the budget.

Governor Shepardson said that there had been discussion of several items, that one item for a clerk had been excluded from the budget in a preliminary review, and that there had also been discussion of two other items, one for \$15,000 and one for \$2,500, and whether they should or should not be included in the budget. Although there had been a difference of opinion at the meeting on December 14 as to whether these last two items should be included, he had interpreted the sentiment of the Board at the conclusion of the discussion as agreeing to include them, with an indication that they should come up for specific consideration by the Board before the actual outlays were made. He had so instructed the Controller.

Governor Mills said that he was under the impression there were other items, possibly an item for around \$195,000 relating to a small business survey.

Governor Shepardson stated that the larger item to which Governor Mills referred had been specifically approved by the Board at the meeting on April 16, 1959, and that the program was moving forward on the basis of that understanding. This item, having been approved previously, was not subject to further consideration.

Governor Shepardson went on to say that he found difficulty in knowing what to do. He had endeavored to follow what he had thought was

the Board's wish by having encouraged the staff to include in the budget when it was prepared all items that might reasonably be needed over the next twelve to eighteen months. He recalled that upon occasion there had been criticism on the part of members of the Board because requests had come to the Board for expenditures considered to be urgent or necessary, or highly desirable, for which no provision had earlier been made in the budget. Criticism at that time was based on the feeling that the staff should have anticipated the possibility of such expenditures at the time the budget was prepared. In the light of that feeling, he had instructed the staff to try to anticipate all such needs with appropriate notations as to any tentative items that were contemplated. In approving them, the Board had in some cases provided that proposed expenditures would be subject to additional review by the Board before they were actually made. Governor Shepardson emphasized that it was not possible to forecast twelve to eighteen months in advance, at the time the budget was prepared, all possible expenditures that might need to be made, and that in any event some requests for supplemental authorizations could be expected by the Board. However, his feeling was that by attempting to anticipate items and showing them as memorandum amounts or as amounts subject to specific authorization by the Board the earlier criticism was being met.

Governor Balderston suggested that the problem was how much money the Board needed in order to operate during the first six months

of 1960. He felt that no substantial difference in the year's expenditures would result, whichever way the matter was handled.

Governor Shepardson responded that certain items were removed from the budget as a result of the Board's discussion at the meeting on December 14. There also had been discussion of two additional items,*the \$15,000 item and the \$2,500 item, and on the basis of his understanding of the discussion at the December 14 meeting, he had instructed the Controller to include them in the budget, but to identify them with a footnote as being items that were subject to the Board's specific authorization before the expenditures were incurred. This, he said, he thought was in accordance with what the Board wished, and he recalled the comment of Chairman Martin at that meeting that it did not make much difference whether the items were included in the budget as long as they were clearly marked to indicate that they were provisional.

Governor Mills said that he recognized that the two items were relatively small in dollar amount. His point, however, was that all items included in the budget gave an indirect consent on the part of the Board and approval that the expenditures be made later on. His concept of a good budgeting procedure was that approval would not be given to any provisional expenditures where there was any doubt about the appropriateness of such expenditures. His position was that the budget was a control and that it should be regarded as such, not as an exercise in probabilities.

^{*} $P_{rovision}$ for certain business cycle statistics and subscriptions.

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Chairman Martin said that he thought the assessment could be made on the basis proposed for the first six months of the year, with the understanding that the Board would take a look at the individual items before the expenditures were made. He did not think it made much difference which way the matter was handled, and the actual cost would come out at the same place under either procedure.

Governor Shepardson said that his point was that neither he nor the staff was sure what procedure the Board wanted to have followed. He would assume full responsibility for any errors in carrying out the Board's intention at the meeting on December 14 since the Controller had raised the question with him and he had instructed him to include the two items in question, with the footnote as indicated. If the Board preferred, the budget could be rearranged to eliminate the two items in question and the assessment recalculated accordingly. In any event, it would be helpful to him and to the staff to know which procedure the Board desired be followed in the future.

Governor Mills then moved that the budget be accepted on the basis on which it had been presented in the memorandum from the Controller With the understanding that the two items about which reservations had been expressed at the December 14 meeting would be brought before the Board for its consideration before the expenditures were actually incurred, and with the further understanding that the assessment would be made upon the Reserve Banks on the basis proposed in the Controller's memorandum. This suggestion was approved unanimously.

Messrs. Connell and Bass withdrew from the meeting at this point.

Possible negligence of a Reserve Bank regarding missort of a check (Item No. 4). There had been distributed a memorandum from Mr. Chase dated December 11, 1959, with respect to liability of a Federal Reserve Bank for a loss resulting from the missort of a check. President Bopp of the Philadelphia Reserve Bank, in a letter dated December 4, 1959, presented the question whether the Reserve Bank should resist a claim by the payee of a check that the Reserve Bank had received in the ordinary course of business but which, as a result of a missort by the Reserve Bank, had been forwarded to the wrong bank with a resulting delay that made it impossible for the payee of the check to receive payment. It was noted that the question presented involved a legal determination as to whether the Reserve Bank was guilty of negligence and, if so, Whether it was responsible to the payee. The General Counsel for the Reserve Bank had reached the conclusion that the Bank probably was legally liable. Mr. Bopp had presented for the Board's consideration the policy question whether the Reserve Bank should attempt to escape liability, even if it could do so under the provisions of Regulation J, Which provide that "A Federal Reserve bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior endorsements." The memorandum from the Legal Division stated that, should the Reserve

Bank be considered legally liable, the policy question would be rendered moot, but since President Bopp had requested the views of the Board on the policy question, a draft letter had been prepared that would express the view that, as a general rule, a Reserve Bank should not resist a claim based on a loss resulting from its own negligence, even though the legal situation were such that it could do so successfully. Copies of the letter would be sent to the other Reserve Banks for their information.

Mr. Farrell stated that it was unreasonable to expect that the Reserve Banks would not occasionally missort checks, that the customary procedure was to reroute them as promptly as possible, and in the event of a claim for loss as a result of mishandling, a Reserve Bank could be expected to use its judgment as to whether to rely on the provisions of the check collection circular and to resist a claim even though litigation might result. In the end, this procedure meant that the question would be one for decision by the courts. Circumstances differed with the Particular instance, and the Reserve Banks endeavored to protect themselves in the light of all the factors. Mr. Farrell had some doubts whether it was appropriate to try to make a policy decision as to voluntary acceptance of liability that would be generally applicable in cases of this sort.

For example, if instead of the \$3,880 check referred to by President Bopp the amount were, say \$1,000,000, there would be a serious question whether the Reserve Bank should settle without a suit.

Mr. Hackley stated that the Board had left to the Reserve Banks a large degree of judgment as to whether to resist or not to resist claims of this nature. He questioned whether the Board should tell the Reserve Banks how to handle these cases, even though it might be unfortunate from the public relations standpoint for a Reserve Bank to resist claims of this type. In Mr. Hackley's judgment, the need for consideration of each case on the basis of the facts applicable made it extremely difficult for the Board to adopt a general policy as to whether Reserve Banks should or should not accept liability in connection with check collection operations.

Chairman Martin said that he felt the Board should not get into the details of Federal Reserve Bank operations of this sort, and he doubted that the System should attempt to have a blanket rule on a question such as that presented by Mr. Bopp.

Governor Szymczak suggested that the proposed letter to Mr. Bopp be revised to indicate that the Board was not prepared to express an opinion on the policy question since the facts might be different in each case that might arise. He also suggested that it would not be necessary to send copies of the correspondence to the other Reserve Banks.

There was unanimous agreement with Governor Szymczak's suggestions. A copy of the revised letter sent to Mr. Bopp is attached as Item No. 4.

Further discussion of Reserve Bank capital accounts. Chairman Martin then referred to the discussion earlier during this meeting of

Reserve Bank capital accounts, stating that, while he did not wish to rush a decision, he felt it would be desirable if the Board could resolve the question before the end of this year. He inquired whether the Board Wished to proceed to consider the matter now or whether it would prefer to take up the question at tomorrow's meeting.

Governor Mills stated that he had prepared a memorandum of his general reasoning on the subject which he would distribute among the members of the Board.

Governor Balderston said that he had discussed with Mr. Thomas
the possible effect on open market operations of any action that the
Board might take which would result in making a substantial payment to
the Treasury around the end of this year, a question that had been raised
by President Hayes of the New York Reserve Bank, as reported at the joint
meeting of the Board and the Reserve Bank Presidents on December 15.
Mr. Thomas had expressed the view that the Trading Desk could adjust its
Operations to take account of any payment of the size that was contemplated.

Mr. Farrell noted that a payment by the Reserve Banks to the Treasury of around \$281 million would be involved, if the Board were to act to close out the reserve for contingencies and to retain earnings sufficient to maintain surplus in an amount equal to 100 per cent of subscribed capital. This would mean, of course, that the payment to the Treasury for December would include all earnings for the year 1959 in excess of the amount needed for maintaining surplus at the year end equal to subscribed capital.

Chairman Martin said that his personal position on the question of open market operations was that the Board should not be considering action with respect to Reserve Bank capital accounts in terms of the Trading Desk. The Treasury was not aware of any consideration being given to this question, but he was confident that in so far as Treasury operations were concerned any necessary adjustments could be made or, in the alternative, operations for the Open Market Account could be adjusted to handle any impact that a payment by the Federal Reserve to the Treasury might have on the money market. Further, he did not believe it desirable for the Board to be in the position of having to explain that action on the interest payment to the Treasury was determined by the effect that such a payment might have on the System's open market operations since it should be assumed that the Desk could do what was necessary to take account of a payment of this size to the Treasury. For reasons such as these, he felt that the decision of the Board--and this was a decision for the Board--would be unnecessarily complicated if it attempted to base its action on the effect that a change in Reserve Bank capital accounts might have on operations for the Open Market Account.

Chairman Martin then suggested that the Board plan to meet at ten o'clock tomorrow morning for the purpose of acting on the proposed change in procedure for handling Reserve Bank capital accounts, and there was agreement with this suggestion.

ASER

Governor Robertson inquired of Mr. Farrell whether he was clear as to the views Mr. Herz had expressed this morning on depreciation accounting for Reserve Banks.

Mr. Farrell responded that there appeared to be some uncertainty as to the details for expensing or capitalizing equipment but that it seemed clear that Mr. Herz was talking of a general dividing line that Would continue to capitalize buildings and some major pieces of building equipment and which would expense most equipment. Mr. Herz had indicated that he would wish to study the details of this but that he had emphasized the desirability of a simplified accounting approach while retaining for the Reserve Banks the conventional approach to depreciation accounting.

Chairman Martin said that from the Board's standpoint it was desirable to try to develop a philosophy of an appropriate depreciation accounting procedure for the Federal Reserve Banks. If this philosophy Were developed, the details did not matter too much.

Governor King indicated that he was favorably impressed by the approach presented by Mr. Herz today and that he would be happy if Mr. Herz could proceed to develop a more complete statement for depreciation accounting by the Reserve Banks along the lines of his remarks.

All of the members of the staff except Mr. Sherman then withdrew f_{rom} the meeting.

Letter from former Governor Vardaman. Chairman Martin referred to the letters he had sent to former Governor Vardaman on July 23 and

RASER

September 24, 1959, regarding a matter raised in a letter dated July 16, 1959, from Senator McClellan, Chairman of the Senate Permanent Subcommittee on Investigations. The Chairman stated that he had now received a letter dated November 18, 1959, from Mr. Vardaman concerning the matters raised by Senator McClellan, that there did not appear to be any further action required at this point in view of the fact that Senator McClellan had referred the matter to the Board for whatever handling it desired, and that he (Chairman Martin) therefore felt it would be in order to file Mr. Vardaman's letter without further action unless the question was reopened by Senator McClellan.

All of the members of the Board concurred in this suggestion.

The meeting then adjourned.

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

Memorandum dated December 4, 1959, from Governor King recommending the increase in the basic annual salary of Doreen Dippre, Secretary to Governor, from \$6,505 to \$7,030, effective December 27, 1959.

Letter to the Federal Reserve Bank of Philadelphia (attached Giacobello, Barold E. Ikeler, Jr., and John F. Manning as examiners.

Secretary



BOARD OF GOVERNORS

FEDERAL RESERVE SYSTEM

WASHINGTON 25, D. C.

Item No. 1 12/17/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE SDARD

December 17, 1959

Board of Directors, Commerce Bank & Trust Company, Helena, Montana.

Gentlemen:

Pursuant to your request submitted through the Federal Reserve Bank of Minneapolis, the Board of Governors of the Federal Reserve System approves, under the provisions of Section 24A of the Federal Reserve Act, the investment in bank premises by Commerce Bank & Trust Company of not to exceed \$315,000 for the purpose of acquiring land and constructing a building thereon to house the operations of the bank.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon, Assistant Secretary.



BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

WASHINGTON 25, D. C.

Item No. 2 12/17/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 18, 1959

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

Dear Mr. Groot:

Reference is made to your letter of November 5, 1959, and enclosures relating to a mutual trust investment fund to be known as Bank Fiduciary Fund of Maine (the "Fund"), which is being incorporated under the provisions of a statute of the State of Maine. The question is whether directors and officers of participating member banks may serve as directors and officers of the Fund, in view of the provisions of section 32 of the Banking Act of 1933.

Briefly, the statute in question authorizes the incorporation of mutual trust investment companies to constitute "a medium for the common investment of trust funds held in a fiduciary capacity capacity and for true fiduciary purposes, either alone or with one or more and for true fiduciary purposes, either alone or with one or more co-fiduciaries, by state banks with trust powers, trust companies and national banks with trust powers which are located in the companies and national banks with trust powers which are located in the State of Maine. The statute restricts the ownership of the Fundamental banks with trust powers which the ownership of the Fund's shares to such fiduciaries in their capacity as such.
The state of Maine. The statute restricts the capacity as such. The statute authorizes the bank commissioner to examine the Fund and to and to require the Fund to make special reports, and gives him the same same power to "direct the discontinuation of any practices which he may he may consider illegal, unauthorized or unsafe" that he has with respect that he has with respect to banks and trust companies, under State law. The assets of the Total Banks and trust companies, under State law. of the Fund may be invested only in assets which are legal investments for trustees under State law. There are appropriate limitations tions on the amount which may be invested in any one corporation, and limit the amount which may be invested in any one corporation, and limitations on the amount of any one trust which may be represented that ions on the amount of any one trust which may be represented to the imposed under the sented by shares of the Fund will apparently be imposed under the regulations regulations to be promulgated under the statute.

Mr. Benjamin F. Groot

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From the information presented, the Board understands that the Fund will receive only funds of trusts created or used for bona fide fiduciary purposes; that no shares of the Fund may be purchased by any institution which operates its own common trust fund; and that the Fund ordinarily will permit the purchase and redemption of shares only on one day during each quarter of the year on the basis of valuations prepared only once each quarter.

It is further understood that the Fund's board of directors or trust composed of at least one member from each participating bank or trust company, subject to the limitation that there will be at least 5 and not more than 25 directors; that no director or officer of the Fund will receive any compensation from the Fund; that a bank will be selected by the Fund as its custodian and investment manager, which bank will have no representation on the Fund's employ no sales personnel, will have no paid employees, will and will impose no sales or loading charges in connection with the per share or sale of its shares (except initially a 25 cent charge per share to recover organizational expenses estimated at \$2,500).

In the issue, flotation, underwriting, public sale or distribution, at wholesale or retail, or through syndicate participation, of any stocks, bonds or other similar securities, except the issue and sale of shares of its own stock.

As your counsel states, the Maine Fund will thus apparently Connecticut Fiduciaries' Fund, Inc., and, accordingly, the proposed in Maine would not be prohibited by section 32 of the Banking Act

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman, Secretary.



BOARD OF GOVERNORS

OF THE

S-1721

FEDERAL RESERVE SYSTEM

WASHINGTON 25, D. C.

Item No. 3 12/17/59

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD
December 17, 1959

Dear Sir:

This refers to Exhibit D of the form of application for prior approval of acquisition of bank shares pursuant to Section 3(a)(2) of the Bank Holding Company Act of 1956 (Form F. R. Y-2), which requires applicant to submit information regarding each office of the bank shown that the Exhibit does not, in many cases, elicit sufficient inforproposed acquisition.

has been obtained by requesting the applicant to file a supplement to tions, and has subjected the applicants to the inconvenience of compiling additional information after completing the application in view toward expediting the processing of future applications it is as noted below, be required to include in their applications the additional information covered by the enclosed description.

There have been a few cases in the past in which the proposed in which involved only a small number of additional shares of a bank example, one application contemplated acquisition of 13 shares of a bank where the bank holding company already owned 501 of the 1,500 obviously shares. In a situation of this kind, the acquisition system of banks, nor would it have any effect upon competition, and not be furnished.

Very truly yours,

Enclosure

Merritt Sherman, Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.



BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

WASHINGTON 25, D. C.

Item No. 4 12/17/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 17, 1959

Mr. Karl R. Bopp, President, Federal Reserve Bank of Philadelphia, Philadelphia 1, Pennsylvania.

Dear Mr. Bopp:

This will acknowledge receipt of your letter of December 4, Reserve Bank should admit liability for the amount of a missorted check payable to A. W. Perdue & Son, Inc.

The legal question is discussed in the comprehensive differ with his conclusion that the claim probably could not be resisted successfully in the courts.

Opinion on the policy question raised in your letter since the facts may be different in each case that may arise.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman, Secretary.



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON 25, D. C.

Item No. 5 12/17/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE SDARD

December 17, 1959

Mr. Joseph R. Campbell, Vice President, Federal Reserve Bank of Philadelphia, Philadelphia 1, Pennsylvania.

Dear Mr. Campbell:

In accordance with the request contained in your letter of December 7, 1959, the Board approves the appointment of Gordon C. Boop, James P. Giacobello, Harold E. Ikeler, Jr., and John F. Manning, at present assistant examiners, as examiners for the Federal Reserve Bank of Philadelphia. Please advise us as to the dates on which the appointments are made effective.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon, Assistant Secretary.