

Minutes for December 18, 1959

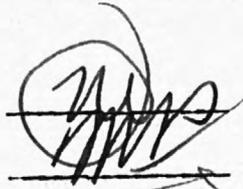
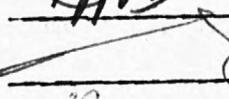
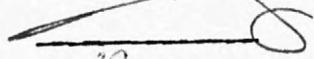
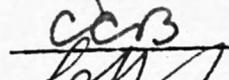
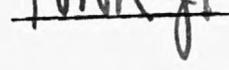
To: Members of the Board  
From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is proposed to place in the record of policy actions required to be kept under the provisions of Section 10 of the Federal Reserve Act an entry covering the item in this set of minutes commencing on the page and dealing with the subject referred to below:

Page 1                      Actions with respect to capital accounts of the Federal Reserve Banks

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

PRESENT: Mr. Martin, Chairman  
Mr. Balderston, Vice Chairman  
Mr. Szymczak  
Mr. Mills  
Mr. Robertson  
Mr. Shepardson  
Mr. 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. Hackley, General Counsel  
Mr. Farrell, Director, Division of Bank Operations  
Mr. Solomon, Director, Division of Examinations  
Mr. Hexter, Assistant General Counsel  
Mr. Daniels, Assistant Director, Division of Bank Operations  
Mr. Landry, Assistant to the Secretary

Discount rates. The establishment without change by the Federal Reserve Banks of New York, Philadelphia, and Minneapolis on December 17, 1959, of the rates on discounts and advances in their existing schedules was approved unanimously, with the understanding that appropriate advice would be sent to those Banks.

Reserve Bank capital accounts (Item No. 1). Pursuant to the understanding at the meeting on December 17, 1959, the Board then took up the question of Reserve Bank capital accounts, particularly with reference to the size of surplus and reserves for contingencies, and with respect to what, if any, action should be taken to change the procedure

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that had been adopted in April 1947 for distributing Reserve Bank earnings. The April 1947 action had provided for levying an interest charge under section 16 of the Federal Reserve Act on Federal Reserve notes not covered by gold certificates that would result in payments to the Treasury equivalent to those that would have been made under the statutory franchise tax that applied to earnings for the years 1918-1932. That franchise tax required that all net earnings after dividends be paid into a surplus fund until that fund amounted to 100 per cent of the subscribed capital of the Federal Reserve Banks and thereafter 90 per cent of net earnings after dividends would be paid to the Treasury as franchise tax and 10 per cent to the surplus fund. Under date of July 10, 1959, a memorandum prepared by Mr. Farrell had been distributed and, on July 17, 1959, following consideration by the Board, Chairman Martin transmitted copies to the Presidents of all Federal Reserve Banks with a request that the topic be placed on the agenda for the next regular meeting of the Conference of Presidents with a view to having a full discussion of the subject at the joint meeting of the Board and the Presidents following the close of that Conference. Such discussion had taken place at the joint meeting of the Board and the Presidents on September 23, 1959, and again on December 15, 1959. In addition to the memorandum of July 10 from Mr. Farrell and other data prepared by the Board's staff, material submitted to the Board included a memorandum prepared by the Presidents' Conference Committee on Research and Statistics in September 1959; a report of the

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Subcommittee on Accounting of the Presidents' Conference dated November 17, 1959; and a memorandum from the Presidents' Conference Committee on Collections and Accounting dated December 7, 1959.

At the meeting of the Board and the Conference of Presidents of the Federal Reserve Banks on December 15, 1959, the Conference expressed the opinion that the present statutory provisions with respect to capital stock of the Federal Reserve Banks should not be modified, but it recommended to the Board of Governors:

- (1) that surplus of Reserve Banks be maintained at 100 per cent of their respective subscribed capital stock;
- (2) that the reserves for contingencies be discontinued and present balances in that account be transferred to profit and loss;
- (3) that the reserve for registered mail losses be likewise discontinued and disposed of (Presidents Allen and Deming voting in the negative);
- (4) that costs of movable furniture and equipment continue to be charged to current expense (Presidents Bryan, Irons, Allen, Erickson, and Bopp voting in the negative);
- (5) that present methods of depreciating building and vault and fixed machinery be continued until the depreciation account equals the asset value of the building and equipment accounts and that the present classification of the components of such accounts as well as current depreciation schedules be re-examined (Presidents Johns and Mangels voting in the negative); and
- (6) that the above adjustments be made at such time and in such manner as the Board of Governors may determine.

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At that meeting, the Chairman of the Conference stated that the Presidents would defer to the Board with regard to the question of timing the necessary adjustments, if the recommendations of the Conference should be concurred in by the Board, but that some of the Presidents had views they wished to express. One such view was that, since the payment to the Treasury under the recommendations would be in the neighborhood of \$250 million, it might have possible effects on open market operations and therefore such a payment might be made in instalments over a period of time or, as an alternative, if it were decided to make such a payment at the end of 1959, one possibility might be to secure an agreement on the part of the Treasury that the funds would be put into the general account and earmarked for release when open market procedures were justified. Another suggestion had reference to the reserves for contingencies, totaling approximately \$98 million, one view being that it might be transferred to profit and loss with payment to the Treasury to be made at whatever time seemed prudent. A third view was that rather than pay over to the Treasury at this time all of the excess over 100 per cent of subscribed capital as the figure beyond which no additions would be made to surplus, the surplus account might be left as at present and the Reserve Banks concerned be permitted to "grow up" to the present 100 per cent of subscribed capital as member bank capital increased and Reserve Bank capital rose accordingly. With respect to methods of depreciation accounting for buildings and equipment, a view also had been expressed that the Reserve Banks might follow precisely the schedules established by the Internal Revenue Service.

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Chairman Martin noted that, as indicated at yesterday's meeting, a memorandum from Governor Mills dated December 17, 1959, had been distributed. This memorandum highlighted the problem, he said, noting that it did not object to releasing to the Treasury the reserves for contingencies and for registered mail losses. Governor Mills' memorandum, however, would reject the suggestion that in the future surplus accounts of the Reserve Banks be held at a level equal to 100 per cent of subscribed capital. Chairman Martin commented that this was a matter of judgment. His personal point of view was that there should be some limitation on the amount of the surplus that could be built up under the trusteeship that the Board had for the Federal Reserve System. He thought there was as much danger of losing the trusteeship by not having a pattern that might be followed as there was by continuing to accumulate funds in surplus beyond what seemed to be an obvious or justifiable limit. He then called for comments that others might have on this general subject.

Governor Robertson said that he felt the important thing was that there be established a procedure which was reasonable, which was understandable, and which the System could justify to anyone as a basis for handling the accounts of the Reserve Banks. He did not feel that the present arrangement under which surplus continued to accumulate indefinitely through the withholding of earnings that might otherwise be paid to the Treasury was one that could be justified. Turning to the recommendations submitted by the Presidents' Conference, Governor Robertson said that he

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would agree with the remarks Mr. Herz had made yesterday regarding depreciation on buildings in that he believed the System should eliminate those items of depreciation that were not long lived, ones which should be charged to expense year by year.

With respect to the reserves for contingencies, he had no question but that they should be dispensed with. With respect to the surplus accounts, Governor Robertson said he ran into some difficulty. It could be said that over the years the Federal Reserve had built up a surplus, first according to statutory provisions, then according to a rule that had been adopted by the Board as a substitute for legislation. That surplus had been built up to a point where it now exceeded in some Banks 200 per cent of paid-in capital or 100 per cent of subscribed capital. For his part, he would not dip into the surplus that had been built up at those Banks. Once having placed the funds in that account, he believed that they should not be taken away. He would, however, announce that hereafter no portion of the earnings of any Federal Reserve Bank would be retained to build up surplus in excess of 100 per cent of subscribed capital. As had been suggested by President Deming, he felt it preferable to "grow up" to the amount of the present surplus.

Governor Shepardson said that he followed much of the reasoning that had been expressed by Governor Robertson. On the matter of depreciation, it seemed to him that the Board might well accept the general philosophy of depreciating buildings and long-lived equipment and expensing

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other items, leaving it to the staff to work out the necessary instructions that would provide the simplified depreciation accounting that Mr. Herz had suggested yesterday. He felt there was no question but that the reserves for contingencies should be wiped out. With respect to the surplus that had been accumulated beyond 100 per cent of subscribed capital at some Banks, it seemed to Governor Shepardson that there was a justifiable rationale for bringing this back down to the 100 per cent figure. (He would prefer to use the term "subscribed" capital rather than "paid-in" capital.) President Deming's suggestion that the Banks now having surplus in excess of subscribed capital be permitted to "grow up" to the present figure of surplus involved essentially a matter of timing. While he did not think that there was any strong case for wiping out the surplus in excess of 100 per cent of subscribed capital, it seemed to him much cleaner to take care of the whole thing at one time. As Governor Robertson put it, this would mean dipping into the surplus of a couple of the Banks. To sum up, he would adopt the practice of maintaining surplus at 100 per cent of the subscribed capital stock of the individual Reserve Banks, he would dispose of the reserves for contingencies and the reserve for registered mail losses, and he would adjust the depreciation accounting to the basis suggested by Mr. Herz at yesterday's meeting, recognizing that the details of this had to be worked out as we could get to them. He would make the changes in so far as they were feasible at the end of the current calendar year. Governor Shepardson added the comment that, in the statement that

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might announce any action to be taken by the Board, it would be desirable not to give the impression that this was a procedure that would be followed for all time to come in the future, but rather to present it as a decision that seemed appropriate at this time on the basis of the experience that the Board had had in studying the arrangements that had been adopted in 1947.

Governor King said he was heartily in favor of eliminating the reserves for contingencies as had been recommended by the Conference of Presidents. He would also favor the approach to depreciation accounting that Mr. Herz had outlined yesterday, and he would wish to minimize the amount of detailed work necessary although he definitely felt it desirable to maintain the framework of a depreciation accounting as applied to buildings. He did not think it made a great deal of difference whether some smaller items were capitalized or expensed. He would be more inclined to exclude items of doubt than to include them in the depreciation accounting. As to the surplus, he would go ahead and reduce the surplus accounts of those Reserve Banks that were now in excess of 100 per cent of subscribed capital whenever the Board felt that it was desirable to move at all. He did not think that there was any great objection to letting the surplus accounts that were presently in excess of 100 per cent of subscribed capital stay there, as had been suggested by President Deming, but on the whole he felt that it would be preferable to make the practice uniform at all the Reserve Banks and have the surplus accounts

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as of the end of this year equal to 100 per cent of subscribed capital. In the long run it did not make much difference whether this practice was followed or whether the one suggested by President Deming was followed.

Governor Szymczak said that he favored the recommendations of the Presidents' Conference, with the recommendations of Mr. Herz as to depreciation accounting to be used as a supplement to those recommendations and the detailed procedures to be worked out as rapidly as the staff could get to it. He did not think that it was necessary to go into great detail in depreciation accounting, and he would hope therefore that the staff could bring to the Board a general procedure that would lean on the side of a simplified approach more than on the side of the detailed accounting approach. As far as announcement of the Board's action was concerned, Governor Szymczak said that he would favor taking action before the end of this year and that he felt the best thing would be for the Board to make a complete statement containing an explanation of just what had been done and of the reasons why it seemed desirable to shift to this basis at the present time.

Chairman Martin said that he would agree, he thought, with the suggestion of Governor Robertson that the statement to be issued should make it clear that this was not an action taken for all time to come. He was not quite certain that he understood the specific proposal that Governor Robertson had made as to how this statement might be worded.

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Governor Robertson said that his proposal would be that the Board should announce that henceforth it was not going to retain out of earnings any sums to build up surplus funds except at those Banks where surplus was less than 100 per cent of subscribed capital. Over a period of time this would mean that the surplus of all Reserve Banks would not exceed 100 per cent of subscribed capital. However, the kind of statement that he had suggested and would have in mind would not make it necessary for the Board and the Reserve Banks to dip into any of the presently accumulated surplus accounts where they now exceeded 100 per cent of subscribed capital. His suggestion would apply to the future and would make it plain that earnings were not to be used hereafter to build up accounts beyond 100 per cent of subscribed capital.

Governor Shepardson said that he still did not think it difficult to justify reducing surplus of those Banks to 100 per cent of subscribed capital where they now were in excess of that figure. He felt that the Board might well answer any questions to the effect that it had studied the procedure that had been followed in past years and had come to the conclusion that, as of the present time, it was not necessary to have surplus accounts in excess of 100 per cent of subscribed capital. Such an explanation would seem to him to be sufficient justification for cutting back at those Banks which were presently above the 100 per cent figure.

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In response to a question from Governor Szymczak, Mr. Farrell outlined the accounting steps that were taken at the present time to make payments to the Treasury of interest on Federal Reserve notes not covered by gold certificates and the steps that might be necessary under a changed procedure such as the Board was now discussing. Mr. Farrell pointed out that this procedure was necessitated because of the provisions of section 16 of the Federal Reserve Act which in effect made it necessary to consider the payment to the Treasury as an expense item.

Mr. Hackley said that in so far as section 16 was concerned, the provision had been put into the law as a means of controlling the volume of Federal Reserve notes outstanding and bringing about a penalty interest payment in the event those issues exceeded the amount collateralized by gold certificates. There was evidence, however, that a secondary purpose of the legislation was to provide revenue to the Treasury. On that basis, the Legal Division had supported the procedure that had been adopted in 1947 and followed since. The procedure had been criticized, for example, by Professor Spahr, and it had also been the subject of some Congressional comment. On the whole, however, it was a procedure which the Legal Division felt was entirely appropriate under the statutory provision. Mr. Hackley went on to say that it might be a little more disturbing to some of those who had criticized the procedure if the Federal Reserve were now to change the procedure to the point of requiring that some of the accumulated surplus be taken away rather than continue a payment

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strictly on the basis of current earnings. He did not believe this too significant.

Mr. Hackley said that there was another point that he wished to call to the attention of the Board in connection with the adoption of the present procedure in 1947. At that time, the Chairman of the Board had taken up with the Chairmen of the Banking and Currency Committees of the House and the Senate the proposal that the Board had in mind before any announcement was made. This was discussed in a manner in which it was apparent that the Chairmen of those Committees had an understanding of what the Board had in mind, and no objection was indicated to the procedure. If the Board were now to decide to take away some of the surplus of the Federal Reserve Banks, it might be in order to take up again with the Chairmen of the Banking and Currency Committees the question of the procedure that the Board intended to follow. Mr. Hackley said that he did not think there would be so much reason for doing this as there was at the time the original change in 1947 was made, and he would think there would be still less reason for bringing a change to the attention of the Banking and Currency Committee Chairmen if the Board were simply to adopt a procedure of paying a higher percentage of net earnings of the Federal Reserve Banks to the Treasury without cutting into the existing surplus accounts.

Chairman Martin stated that he felt this was a good point for the Board to bear in mind. He then called upon Governor Balderston for a

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comment on the subject noting that he, too, had distributed a memorandum to the members of the Board subsequent to yesterday's meeting. Governor Balderston's memorandum read as follows:

The case for the retention of the capital and surplus of the country's central banking system has been set forth but ineffectively in the report of the Patman Committee published in 1952. (See pages 646-648)

As to how much surplus should be retained, the consensus of the twelve Federal Reserve Bank Presidents, in the light of the System's 45 years' experience, together with certain provisions of the law, supports the view that a surplus equal to double the paid-in capital is appropriate. I see no reason to disagree.

As to the reserve for mail losses, actual experience with the risks that are borne now justifies the elimination. The same may be said for the contingency reserve, despite the fact that the present value of our portfolio is below cost, because of the abundance of short-term securities in relation to such selling as is required by the economy. This conclusion also is concurred in by the Bank Presidents.

As to depreciation reserves and the accounting incident thereto, I find no compelling basis for their retention. In contrast to private industry, the Federal Reserve has no pricing problems requiring unit costs that include a proper allocation of overhead. Neither does the Federal Reserve need to compute taxable income as a basis for paying income taxes. Nor do the dividend decisions of the several Federal Reserve Bank boards, being set by statute, require determination of the sum available for dividends in order to avoid dividend payments that would be improper. Moreover, depreciation is a non-cash item, and its computation does not help the directors and officers to control expense. Unless the System's auditors urge the retention of depreciation accounting, I would abandon it both at the Federal Reserve Banks and Board as a fruitless operation.

If the Board should decide upon some or all of these changes in policy, when should they be implemented? Although I was at one time attracted by the neatness of making a payment in February when the Treasury owes the Federal Reserve \$250,000,000, I now

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hold the view that the payment should be made as of the end of 1959. However, payment of the reserve for mail losses may need to be deferred until after formal approval by the several Bank boards. Here I am relying on the advice of Mr. Farrell that there are no accounting problems that are insuperable and upon that of Mr. Thomas that no money market problems would be created that the Desk could not overcome. My principal reason for advocating that policy actions be implemented by a payment as of the end of this year is to permit the question to be treated in its entirety in the 1959 report. If after long consideration, the Board decides that a change of policy is now the right course to follow in the light of the System's experience of 45 years, then I favor making the resultant payment to the Treasury at once.

Governor Balderston said that his position on the reserves for contingencies was the same as appeared to be the view of all of the other members of the Board. In other words, he would abandon those reserves. As to the depreciation accounting, he would accept the solution that had been suggested by Mr. Herz yesterday, but this would be for public relations reasons only. He found no compelling basis for retaining depreciation reserves in the Federal Reserve System. The most rational approach would be to abandon completely depreciation accounting for the Federal Reserve Banks. Under all the circumstances, however, he would accept the suggestion made by Mr. Herz that retention of a conventional approach was probably in the best interests of the Federal Reserve and of the business community. With respect to the surplus accounts, Governor Balderston said that he was impressed by the importance of having a carefully worded statement explaining what the Board had done when it came to describing this action in the policy section of the forthcoming annual report. He also felt that this would be necessary in

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a release to the press for the reasons that Governor Mills had brought out in his memorandum distributed yesterday. Governor Balderston said that another point he would make was that the release the Board made announcing action that it might take between now and the end of this year should be so worded as to make plain that it was not setting up a rule that would hold for all time in the future. He felt there was a slight advantage in the approach that Governor Shepardson had suggested that surplus be expressed in relation to the amount of subscribed capital rather than to paid-in capital, although he did not think this was very important. As to Governor Robertson's point regarding surplus accounts and not dipping into them, he could see the arguments on both sides. He had sympathy with the view that Governor Robertson had expressed that it would be better for the Federal Reserve not to set a bad example of dipping into a surplus account on a voluntary basis. Such a procedure would be in accordance with the best accounting practices. On the other hand, there was a problem that Chairman Martin had had to face in some of the hearings during the past year on the matter of the surplus accounts of the Federal Reserve Banks. Whatever solution the Board came to, the important thing was to make clear what the Board's current policy was. Obviously, the System should not be keeping back 10 per cent of net earnings after payment of dividends in that this was something that could not be satisfactorily explained to Congress or in other quarters. Governor Balderston then outlined in some detail the kind of statement that he thought the Board might

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prepare to issue announcing an action that it might take at the present time, and there followed discussion of several suggestions made regarding the form of such a statement.

Chairman Martin commented that the simplest thing to do was to say that the present Board had arrived at the view that 100 per cent of subscribed capital was sufficient as a surplus for the Federal Reserve Banks and that any time that a Bank's surplus fell below that level it would be brought back up to such a figure. Any earnings over and above that amount would be paid to the Treasury. As to the amount of the surplus, Chairman Martin stated that the figure of 100 per cent of subscribed capital was a more or less arbitrary amount that had some background in the earlier legislation relating to the payment of a franchise tax. This, however, was not a particularly binding figure and the Board, if it wished, could set 150 per cent or 200 per cent or some other figure as one that would be about equally defensible. Chairman Martin said that he had great sympathy with Governor Robertson's feeling that the present surplus accounts of the Reserve Banks should not be reduced. On the other hand, he had some difficulty in knowing how to explain the retention for two or three Banks of surplus in excess of 100 per cent of subscribed capital when all of the others would be at that figure if the action under discussion were taken.

Governor Robertson responded that while this might be a problem, his judgment was that it would not be difficult to make clear to the

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Congress or to the public that the Federal Reserve had decided that hereafter earnings should not be used to accumulate surplus beyond 100 per cent of subscribed capital. The same statement could note that at certain Banks the surplus accounts were now somewhat in excess of that figure and that no additions would be made to those accounts until such an addition was necessary in order to bring the individual Bank's surplus up to 100 per cent of its subscribed capital. In his judgment, this would not be a difficult matter to explain.

Governor Shepardson reiterated the view he had expressed earlier that the cleanest procedure would be to fix the amount at 100 per cent of subscribed capital for all Banks at the same time, simply stating that on the basis of experience and a review of the needs for surplus the Board had concluded that it was not necessary to have surplus in excess of 100 per cent of subscribed capital.

After some discussion of this question, Chairman Martin stated that the important point to him was that the Board and the System get across in some manner that the real point was that the Federal Reserve intended to pay its earnings in excess of its needs for surplus to the Treasury and to review these needs from year to year. He felt that the preparation of a statement for the press was something that would have to be worked out, but his general approach would be along the lines he had indicated. The statement should not be made too complicated and it should be recognized that except in a relatively limited area it would not stir very much interest.

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The Chairman then said that he gathered there was agreement on the part of all members of the Board with the recommendation of the Conference of Presidents of the Federal Reserve Banks that the reserves for contingencies be discontinued and the present balances in those accounts transferred to profit and loss. In addition, there was agreement that the reserve for registered mail losses be discontinued and disposed of as promptly as that could be done in view of the fact that the loss sharing agreement would have to be amended.

Governor Mills stated that he agreed with this part of the proposal submitted to the Board but that he would like to state his position more fully and that he would like to have the statement he had distributed to the members of the Board yesterday placed in the minutes as a fuller expression of his views. He went on to say that he favored the release of the general contingency reserves and the reserve for registered mail losses. Also, he was favorable to the release of the depreciation reserves but that action should be delayed until an appropriate accounting procedure had been established that would determine the future method of taking depreciation and of accumulating reserves above the present amount at whatever necessary level seemed appropriate at the time. As to the proposal to pay 100 per cent of earnings to the Treasury, Governor Mills said that he was opposed to such a procedure. He believed that there were good and sufficient reasons for the Federal Reserve to continue to make reasonable additions to surplus accounts and that the Board should

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go to the Congress after adequate study to determine what manner of franchise tax or what manner of statute should be passed that would flexibly determine the percentage of earnings that should be paid to the Treasury after deductions of expenses and dividends.

Chairman Martin said that Governor Mills' written statement would also be included in these minutes as a more complete expression of his views. His understanding was that Governor Mills favored discontinuance of the reserves for contingencies and the reserve for registered mail losses but that he did not favor paying to the Treasury all earnings in excess of the amount needed to maintain subscribed capital at 100 per cent. Governor Mills' statement distributed prior to this meeting read as follows:

The Board of Governors now has under consideration whether

(1) the contingency reserves and reserves for registered mail losses should be removed from the capital accounts of the Federal Reserve Banks and released to the United States Treasury as a miscellaneous receipt;

(2) a revision of the depreciation procedures of the Federal Reserve Banks should be made which in effect would increase the earnings of the Federal Reserve Banks and hence consequent payments to the United States Treasury;

(3) the capital and surplus accounts of the Federal Reserve Banks have now reached a total to which no further additions need be made from their earnings beyond an amount that would at all times maintain their surplus accounts at twice the amount of their issued and paid-in capital stock.

In the writer's opinion, there is no serious objection to releasing to the United States Treasury the aforementioned reserves or in reconstituting the depreciation practices of the Federal Reserve Banks in a manner more in keeping with the

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practices followed in private commerce and industry. However, it must be recognized that the proposed action, taken at this time when the Federal Reserve System is under fire, can be regarded by some as a confession of past error and by others as submission by the Federal Reserve System to a raid on its resources by the Executive Branch of the Federal Government.

The doctrine has been expounded at different times that the Federal Reserve System is a public trusteeship of which the members of the Board of Governors are the trustees. In the writer's opinion, adoption of the proposal that future additions to the surplus accounts of the Federal Reserve Banks be limited only to those amounts that would maintain the surplus accounts at twice the amounts of the paid-in capital of the Federal Reserve Banks breaks faith with the principle of trusteeship and should be rejected. Acceptance of the proposal would in effect proclaim that the Federal Reserve Banks are no longer the mixed type of private and public corporation that was contemplated by the Federal Reserve Act but, instead, are to be integral and direct appendages of the Federal Government. As such, the Federal Reserve Banks and the Board of Governors could no longer justify independent authority to the disbursement of funds at their disposal and could not object to action taken that would cover all employees of the Federal Reserve System into the Civil Service System. By the same token, the changed status of the Federal Reserve Banks would relegate their directors to the capacity of mere consultants in view of the changed character of the Federal Reserve System that would have taken place.

Prediction of the consequences of adoption of this proposal reverts to the fact that the Federal Reserve Banks are looked upon by the general public as being semi-private corporations operated under Federal Government supervision but accountable for their own funds and responsible to the public for maintaining a tangible financial strength equal to absorbing all losses which might derive from their operations and without having to resort to the U. S. Treasury for assistance in order to fulfill their statutory responsibilities. In order to maintain this "character" it is essential that the Federal Reserve Banks represent a corporate financial structure in keeping with their liabilities, which cannot be done if additions to their surplus accounts from earnings are limited in the manner proposed. This is not to say that a larger share of

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Federal Reserve Bank earnings should not be paid over to the United States Treasury than is now the practice, and in accordance with some newly prescribed formula that would find acceptance by the Congress.

To illustrate the importance for the Federal Reserve Banks to operate through a capital structure consistent with the ideals and practices followed in private life, attention is called to Henry Hazlitt's editorial in the December 21, 1959 issue of Newsweek, which takes radical exception to a recent suggestion of Roy Reiersen that it is no longer necessary for the Federal Reserve System to operate on the basis of a statutory gold reserve. Mr. Hazlitt contends that elimination of the gold reserve would be destructive not only of custom but of the discipline that a gold reserve exerts toward demanding conservative Federal Reserve System operating policies.

Somewhat the same charges could be raised if the proposal under discussion was adopted and the surplus accounts of the Federal Reserve Banks fell below a total that would be looked upon by the public as being consistent with their liabilities. In that connection, it must be remembered that the liabilities of the Federal Reserve Banks, as represented by their deposits and outstanding Federal Reserve notes, have multiplied in proportion to the depreciation of the dollar in recent years, and hence it is all the more essential that public confidence in the Federal Reserve System be maintained by tangible evidence that the capital accounts of the Federal Reserve Banks are maintained at appropriate levels.

It is acknowledged that theoretically the Federal Reserve Banks do not require capital, and likewise that their actual capital funds do not have to be as great in proportion as those that are prescribed by the bank supervisory authorities for private banks, in that their risk assets are minimal in quality. However, when it is considered that the combined capital of all of the Federal Reserve Banks is not greatly in excess of the individual capital accounts of several of the nation's leading private banks, it is brought home clearly that failure of the Federal Reserve System to maintain an appropriate capitalization for the Federal Reserve Banks would be destructive of confidence in the System and thence contrary to public policy.

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Governor King stated that he agreed with the general approach indicated by most of the members of the Board, that is, the reserves for contingencies to be discontinued, the depreciation procedures to be reviewed along the lines indicated by Mr. Herz yesterday, and that a statement of the Board's action be made in the simplest terms possible. He did not think it very important whether we talked of 100 per cent of subscribed capital or 200 per cent of paid-in capital; in fact, he could argue there was a mild form of deception if 100 per cent of subscribed capital was used, but he did not think this was important.

Chairman Martin then inquired whether the Board was ready to act on the question of disposing of the reserves for contingencies and the reserve for registered mail losses. There being no indication of dissent, the Chairman went on to say that it would be understood that the Board was unanimously voting to discontinue the reserves for contingencies and the reserve for registered mail losses, it being understood in connection with the latter that it might not be possible to accomplish that step before the end of this year in view of the need for amending the loss sharing agreement which required action by all of the Federal Reserve Banks.

The Chairman then stated that, with respect to the disposition of the surplus of the Federal Reserve Banks, he understood that all of the members of the Board favored payment to the Treasury of all earnings in excess of 100 per cent of subscribed capital except Governor Mills, who as indicated before, would oppose that action.

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Governor Robertson noted that he was opposed to paying to the Treasury a portion of surplus at those Federal Reserve Banks where their present surplus accounts exceeded 100 per cent of subscribed capital. Otherwise, he would favor action as stated by Chairman Martin.

Mr. Hexter suggested that there might be a legal problem arising should the Board dip into surplus at some of the Reserve Banks because of the wording of section 7 of the Federal Reserve Act which provides that after the annual dividend of 6 per cent of paid-in capital net earnings shall be paid into the surplus fund of each Reserve Bank. Payments to the Treasury had been regarded as necessary expense and, should the necessary expense exceed this year's earnings, there would be no net earnings from which dividends could be legally paid.

Mr. Daniels commented that the System occasionally in the past had suffered deficits after the payment of dividends and that he felt therefore that the point Mr. Hexter made had already been covered by action taken by the Board in at least one or two past years.

Mr. Hackley remarked that the Board could be accused of inconsistency in adopting a proposal such as that just approved by the Board in view of the suggestion contained in the Financial Institutions Act in 1957 proposing that the franchise tax be restored and that 90 per cent of net earnings of the Federal Reserve Banks after dividends be paid to the Treasury as a franchise tax.

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On the point raised by Mr. Hackley, it was noted that net earnings of the System had increased substantially in recent years and that if this question arose an appropriate answer would be that, because of the substantial rise in net earnings in recent years, it appeared that the 90 per cent figure proposed in 1957 was no longer appropriate.

Governor Robertson then noted that the question of depreciation on buildings had not been settled and that no change in the procedure could be made effective before the end of this year so far as additional payments to the Treasury were concerned since it would be necessary not only to develop the philosophy more fully but to work out the detailed accounting procedures for that subject.

Governor Shepardson suggested that it would be desirable for the Board at this time to take action to the effect that it was the policy of the Board that furniture and equipment not be depreciated, that the Board favored continuation of depreciation for buildings for public relations reasons as discussed earlier, and that a simplified accounting procedure should be worked out to implement this policy more or less along the lines that had been suggested by Mr. Herz at yesterday's meeting of the Board.

Mr. Farrell stated that he would prefer that the Board not adopt too tight a guide as to the depreciation accounting procedures that might be followed at this time. This was a subject that would require considerable study on the part of the Board's staff; it was one

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in which the Reserve Banks would have great interest; and it would be desirable to have the benefit of the suggestions of Mr. Herz of Price Waterhouse before a definite procedure was agreed upon by the Board.

Governor Shepardson responded that he had not intended to cover details in his suggestion but merely wanted to have the record show that the general approach that had been discussed was one that the Board favored. It was understood that the details for this procedure would be worked out in the future and submitted to the Board for its consideration again.

Chairman Martin stated that this was his understanding and that the record would show that the Board was in agreement with this procedure. The Chairman went on to say that the Board had now agreed that the reserves for contingencies and the reserve for registered mail losses would be discontinued at the end of this year and that payments to the Treasury would be calculated on the basis of maintaining surplus at 100 per cent of subscribed capital.

Mr. Farrell raised the question as to whether the Chairman had intended to state that the reserve for registered mail losses be discontinued at the end of 1959, noting that it would be difficult to bring about the necessary amendment to the loss sharing agreement within the time limit suggested. Mr. Farrell also called attention to the fact that the amount of this reserve was in the neighborhood of \$11 million.

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Chairman Martin responded that it was not important whether this amount be closed out before the end of 1959 or after the end of the year. He had merely intended to include it as indicating the Board's action and not as to the time when that reserve would be closed out.

There was no indication of disagreement with the statement made by Chairman Martin.

Chairman Martin then said the question was how to proceed to implement the decisions that the Board had taken at this meeting. The important point of establishing a principle was the one that he was most concerned with and, if necessary, the details for working out the accounting steps could take more time. He also felt it important that the principle that the Board would periodically review the amount of surplus that was carried by the Reserve Banks be made clear in the Board's record and any statement issued. He thought that it should not appear that when the Reserve Banks had reached a certain level of surplus the accumulation was going to continue indefinitely at that same rate. He felt it would be undesirable to close out the reserves for contingencies and to discontinue accumulations to reserve accounts without promptly paying the funds to the Treasury, thus leaving a large sum that would appear in the Reserve Bank statements at the end of this year. For this reason, he would favor working out a procedure under which the earnings and accumulations in excess of the amount needed to bring surplus to 100 per cent of subscribed capital would be paid to the Treasury before the accounts were closed at the end of this year.

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Mr. Solomon raised a question as to whether the Reserve Bank Presidents would understand the action being taken, that is, whether they would really be satisfied that their recommendation was being accepted if they learned that their surplus accounts were being dipped into. Such an action, Mr. Solomon suggested, might be a surprise to some of the Reserve Bank Presidents if they were told that that was what they had recommended in proposing that the surplus accounts of the Reserve Banks be maintained at 100 per cent of their respective subscribed capital stock.

Mr. Farrell stated that the action being discussed, including the reduction in the surplus accounts that were presently in excess of 100 per cent of subscribed capital, was precisely what the Presidents had in mind in using the word "maintained" at 100 per cent of subscribed capital.

Chairman Martin said that he believed that the Presidents' recommendations were quite clear and covered rather adequately the System view as a whole. The more he thought about the proposal and the more that it was debated, the more he believed it to be important that the System wind up the question and reach a decision. It could be criticized from different angles. However, his feeling would be to try to reach a decision and to make the action effective as near the end of the current year as possible. He did not think the question as to the registered mail reserve was important and, in fact, it could be argued that it was as well to let it be closed out after the turn of the year. On the balance of the

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proposed actions, however, his decision would be to act now with a view to having the necessary implementing procedures undertaken before the end of the year.

Governor Balderston stated that he believed an essential point was also to have the annual report for the year 1959 record completely the actions taken by the Board.

Governor Robertson then said that he would like to review the actions that were proposed in order to be sure that he understood just what the minutes of this meeting would reflect. As he understood it, the decision that had been reached would bring about the closing out of the reserves for contingencies, it would provide for closing the reserve for registered mail losses as soon as practicable, it would provide for maintaining the surplus of the Reserve Banks at 100 per cent of their respective subscribed capital stock and for paying to the Treasury the amount that would be involved in these various transactions at the end of this year.

Chairman Martin responded that this was the action that had been agreed upon, with Governor Mills dissenting as to the decision to maintain the surplus accounts at 100 per cent of subscribed capital.

Governor Robertson then stated that he, too, would wish to dissent with respect to "maintaining" the surplus at 100 per cent of subscribed capital in that he disagreed with the decision to dip into the surplus account of any Bank where that fund was presently in excess of 100 per cent of subscribed capital.

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Chairman Martin stated that this dissent also would be recorded in the minutes of this meeting.

In response to a question as to whether the views of the dissenting members should be mentioned in the year-end statement of earnings, Chairman Martin stated that he could see no need of stating at that time the views of individual members of the Board. He felt that it would be desirable, however, for the Chairmen of the Banking and Currency Committees of the House and Senate to be informed promptly of the action that the Board had taken. He also suggested that it would be desirable to inform the Treasury, which had not previously been told of the contemplated action, of the decision that the Board had reached.

Governor Shepardson inquired whether it might not be feasible to bring about the necessary amendment to the loss sharing agreement in order that the reserve for registered mail losses also could be closed out before the end of the year, and Chairman Martin responded that he did not think this was important.

Mr. Farrell stated that it might be possible to bring about this action and that if Mr. Mangels as Chairman of the Committee on Collections and Accounting and Mr. Fulton as Chairman of the Committee on Miscellaneous Operations believed that it would be feasible, there would be no difficulty from the standpoint of the Board and its accounting instructions in including this part of the action along with the others before the end of this year.

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Chairman Martin then suggested that the implementation of the actions the Board had taken be carried out in the usual manner, with the understanding that Mr. Fulton as Chairman of the Committee on Miscellaneous Operations would be informed immediately of the decision reached in order that he might ascertain whether it would be feasible to include the closing of the reserve for registered mail losses before the end of 1959. It was understood that the staff would proceed with the necessary steps to bring about the closing of the reserves for contingencies and notification to the Reserve Banks of the accounting steps to be taken looking toward the year-end adjustments.

Secretary's Note: Pursuant to the foregoing actions, a telegram in the form of attached Item No. 1 was dispatched to the Presidents of all Federal Reserve Banks later in the day, it having been ascertained from Mr. Fulton that he did not believe it to be feasible to conclude the necessary amendment to the loss sharing agreement in time to permit the closing of the reserve for registered mail losses before the end of 1959.

Discussion with Treasury representatives of currency verification and destruction procedures. Governor Robertson reported that he, President Mangels, and Mr. Farrell met with Under Secretary of the Treasury Baird, Fiscal Assistant Secretary Heffelfinger, Technical Assistant Stickney, and Mr. Hall, Deputy Treasurer, on December 16 to discuss verification and destruction procedures being followed at the Reserve Banks with respect to Treasury currency. They presented views along the lines of those

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discussed at the joint meeting of the Board with the Reserve Bank Presidents on November 24, 1959, which they believed to be representative of the System's position on this question, namely, that they believed that the currency destruction procedures were fraught with danger and that additional precautionary measures should be taken in connection with the Treasury currency being destroyed at the Federal Reserve Banks. Governor Robertson said that they stated that they would prefer to have the entire operation taken back by the Treasury, that if that were not feasible they would prefer a procedure whereby the Treasury notes were cut in half longitudinally and one-half delivered to a currency verification unit at each Federal Reserve Bank while the other was delivered to a new currency custody unit at each Bank. Estimates received from the Federal Reserve Banks indicated that operations under the proposed procedures would be more costly than under the present arrangements by about \$65,000 per year in reimbursable expenses and \$144,000 in nonreimbursable Money Department costs. It was expected that audit expense would be about the same.

Governor Robertson went on to say that he sensed that Under Secretary Baird was open minded on the question and that he had agreed to study the matter further. Messrs. Heffelfinger and Stickney took a rigid position against a change in the existing procedures and expressed the view that some of the Federal Reserve Banks had already gone beyond the precautions that were required for this operation. They took the position further that they could not possibly get an additional appropriation from

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the Congress for this operation and were not inclined to make such a request. Mr. Hall did not express himself. Governor Robertson stated that his reaction to the discussion was that if the matter were to be left to Messrs. Heffelfinger and Stickney, there would be no change whatsoever in the present policy. He did not get the impression from Mr. Baird that there was a definite likelihood one way or the other, but it was his personal view that if anything further were to be done it would probably be necessary for Chairman Martin to discuss the matter direct with Secretary of the Treasury Anderson. He felt that inasmuch as all of the Federal Reserve Bank Presidents believed that additional precautionary measures were needed it might ultimately result in some steps being taken along the lines of the report of the ad hoc committee that was working on this matter, prepared under date of November 12, 1959, and transmitted in a letter report to the Presidents of all Federal Reserve Banks on that date.

Possible legislative proposals. There had been distributed a memorandum from Mr. Hackley dated December 17, 1959, attaching a copy of a memorandum to Chairman Martin dated December 10, 1959, regarding possible proposals for legislation at the forthcoming session of Congress.

Mr. Hackley said that only three proposals, aside from a possible amendment regarding cost of Reserve Bank branch buildings, appeared to merit serious consideration at this time: (1) the extension beyond its present expiration date of June 30, 1960, of the provision of section 14(b)

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of the Federal Reserve Act regarding direct purchases of securities by the Federal Reserve Banks from the Treasury; (2) the possibility of recommending that section 19 of the Federal Reserve Act be amended to provide that a payment of interest on deposits shall include only cash payments made, or credits given, by a member bank for the account or benefit of depositors; (3) the possibility of the Board's renewing its proposal with respect to bank merger legislation according to which all bank mergers would require approval of the appropriate Federal banking agency, including a provision authorizing the banking agency in each case to request the opinion of the Attorney General as to whether the bank merger would lessen competition unduly.

With reference to the first proposal, Mr. Hackley noted that the Treasury had taken the initiative for legislation with respect to the direct purchase authority in the past several years. As to the second proposal regarding a definition of "interest" on deposits, a change of the kind suggested, which was similar to one proposed by the Board in the fall of 1956 for inclusion in the Financial Institutions Act, might tend to encourage evasions and thus to defeat the basic purposes of the legislation. The argument for such a proposal was that it would simplify the administration of the statute regarding payment of interest on deposits. So far as the third proposal was concerned, Mr. Hackley said that bank merger legislation probably would be more controversial in the coming year than in the past. Although the three Federal bank supervisory agencies

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were in agreement on the proposal outlined above, the Department of Justice had strongly urged that it be given the veto power over bank mergers and it also had taken the position that no bank merger should be approved that would "substantially" lessen competition.

In the ensuing discussion, during which it was understood that no action toward actually introducing any of the legislative proposals presented in Mr. Hackley's memorandum would be taken at this time, Mr. Hackley referred to the letter that had been approved by the Board at its meeting on December 14, 1959, replying to a letter from Representative Wright Patman dated December 3, 1959, regarding payment of interest on demand deposits by member banks of the Federal Reserve System. Mr. Hackley noted that in the letter approved on December 14 reference had been made to the Board's position in the Financial Institutions Act, and he suggested that it might be desirable to delete this reaffirmation of a position taken earlier in view of the fact that there was a real question as to whether such a proposal might weaken the purpose of the statute prohibiting payment of interest on deposits. There was agreement that the letter that had been approved on December 14, the mailing of which had been deferred, should be changed to eliminate any reference to a recommendation by the Board for legislation on this subject.

Secretary's Note: A copy of the letter sent to Congressman Patman on December 18, 1959, is attached to the minutes of December 14, 1959, as Item No. 3.

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All of the members of the staff except Messrs. Sherman and Fauver then withdrew from the meeting.

Appointment of directors. Chairman Martin stated that as a result of further discussions with Chairman Hall of the Federal Reserve Bank of Kansas City and Mr. Neilson, retiring Chairman of the Board of Directors of the Denver Branch of that Bank, he was now prepared to recommend the appointment of Mr. Robert T. Person, President of Public Service Company of Colorado, as a director of the Denver Branch for the two-year term beginning January 1, 1960.

Following a brief discussion including reference to the fact that Mr. Person was connected with a public utility, it was agreed unanimously that the usual steps should be taken to ascertain whether he would accept such appointment if tendered, and, if he would, to make the appointment.

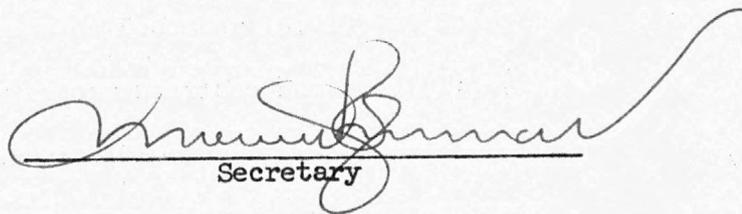
Chairman Martin then stated that Mr. Murphy, President of Campbell's Soup Company, had concluded that he should not accept appointment as a Class C director of the Federal Reserve Bank of Philadelphia. As an alternate, the name of David C. Bevan, Financial Vice President, Pennsylvania Railroad Company, had been proposed. This suggested appointment was discussed and at the conclusion there was agreement that the usual steps should be taken to ascertain whether Mr. Bevan would accept the appointment if tendered and, if so, to make the appointment.

The meeting then adjourned.

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Secretary's Note: Pursuant to the recommendation contained in a memorandum from Mr. Hersey, Associate Adviser, Division of International Finance, dated December 11, 1959, Governor Shepardson today approved on behalf of the Board the transfer of Patricia Gannon from the position of Secretary in the Office of Defense Planning to the position of Secretary in the Division of International Finance, with no change in her basic annual salary at the rate of \$4,790, effective the date she assumes her new duties.



Secretary

T E L E G R A M  
LEASED WIRE SERVICEItem No. 1  
12/18/59BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON

December 18, 1959

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

Board has taken action today concurring in recommendations of Presidents' Conference with respect to Reserve Bank fixed asset and capital accounts as set forth in items numbered one through five under Topic 1 of the memorandum submitted for consideration at the joint meeting of the Board and the Presidents on December 15, 1959. Board desires that adjustments required by recommendations numbered (1), (2), and (3) be made effective by December 31, 1959.

Effectuation of these three recommendations would necessitate closing out the reserves for contingencies, including the reserve for registered mail losses, and crediting the amounts to profit and loss on or before December 31. However, recommendation Number (3) that the reserve for registered mail losses be discontinued and disposed of requires amendment of the loss sharing agreement of the Federal Reserve Banks, which action must be approved by the Banks' boards of directors and by the Board of Governors. This matter has been discussed with Mr. Fulton who indicated there may be some difficulty in implementing recommendation No. (3) before end of this year.

Surplus in excess of 100 per cent of subscribed capital stock as of the close of business December 31, 1959, will be closed out and payments in such amounts included with interest payments to the Treasury for December 1959.

Board plans no press release or other announcement regarding this action until usual statement for the press re earnings and expenses of the Federal Reserve Banks during 1959 is released early in January 1960.

(Signed) Merritt Sherman

SHERMAN