



Minutes of the Board of Governors of the Federal Reserve System  
on Friday, February 19, 1960. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman 1/  
Mr. Balderston, Vice Chairman  
Mr. Szymczak 2/  
Mr. Mills  
Mr. Robertson  
Mr. Shepardson  
Mr. King

Mr. Sherman, Secretary  
Mr. Thomas Adviser to the Board  
Mr. Young, 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. Noyes, Director, Division of Research  
and Statistics  
Mr. Farrell, Director, Division of Bank  
Operations  
Mr. Solomon, Director, Division of Examinations  
Mr. Johnson, Director, Division of Personnel  
Administration  
Mr. Connell, Controller  
Mr. Hexter, Assistant General Counsel  
Mr. Williams, Associate Adviser, Division of  
Research and Statistics  
Mr. Conkling, Assistant Director, Division of  
Bank Operations  
Mr. Bass, Assistant Controller  
Mr. Landry, Assistant to the Secretary

Discount rates. The establishment without change by the Federal Reserve Banks of New York, Philadelphia, Chicago, and San Francisco on February 18, 1960, 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.

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Withdrawn from and re-entered meeting at points indicated in minutes.  
Withdrawn from meeting at point indicated in minutes.

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Item circulated to the Board. The following item, which had been circulated to the members of the Board and a copy of which is attached to these minutes as Item No. 1, was approved unanimously:

Letter to the Federal Reserve Bank of San Francisco approving the payment of salaries to two officers of the Bank at rates fixed by the Board of Directors.

Call for condition reports. It was reported that advice had been received on February 15, 1960, from the Office of the Comptroller of the Currency that the Comptroller would make a call on all national banks this spring for reports of condition and in accordance with the usual practice a telegram had been sent to the Federal Reserve Banks indicating that the Board contemplated making a similar call upon State member banks.

The action taken in sending the telegram to the Reserve Banks was ratified by unanimous vote.

Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, entered the room at this point.

Letter to Senator Byrd commenting on S. 2813. There had been distributed under date of February 15, 1960, a letter to Senator Byrd, Chairman of the Senate Finance Committee, replying to his request for comment on S. 2813, "To provide for more effective management of the public debt by removing the remaining interest rate restrictions on public issues of Government securities...".

Extensive changes were suggested in the draft letter during the discussion that followed in order to clarify certain passages,

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including a suggestion that the letter place more stress on the impact on monetary policy of the present interest rate ceiling of 4-1/4 per cent on public issues of Treasury securities with maturities of five years or more.

It was decided that a redraft of this letter be prepared for consideration by the Board at a meeting in the near future.

Messrs. Thomas and Keir then withdrew from the meeting.

Letter to Senator Robertson (Item No. 2). There had been distributed a draft of letter to Senator Robertson, Chairman of the Senate Banking and Currency Committee, reporting on S. 2382, a bill introduced by Senator Clark of Pennsylvania "To amend the Employment Act of 1946 to provide for its more effective administration and to bring to bear an informed public opinion upon price and wage increases which threaten economic stability." The letter indicated the Board's opposition to the enactment of S. 2382, not only because the provisions of the bill relating to price and wage increases that appear to threaten economic stability would put the Government into the business of price and wage determination, but also because the concepts of "sustained growth" and "reasonable price stability" are implicit in the Act as it stands and the proposed changes were contrary to the legislative foundation and subsequent development of the Federal Reserve System.

Mr. Shay observed that since the hearing on this bill was scheduled for next Wednesday, February 24, in view of the holiday next Monday, February 22, the letter should be sent to Chairman Robertson

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either this afternoon or early next Tuesday morning. He added that he had received a call from a staff member of the Council of Economic Advisers requesting a copy of the Board's letter to permit Chairman Saulnier of the Council to have it on hand when he testified at the open hearing on this bill.

The letter to Chairman Robertson (attached Item No. 2) was then unanimously approved.

Messrs. Shay and Williams then withdrew from the meeting.

Letter to Mr. Gesell, Counsel for Firstamerica. There had been distributed a draft letter to Mr. Gesell, attorney for Firstamerica Corporation and California Bank, answering his letter of February 11, 1960, regarding the pending litigation between the Department of Justice and Firstamerica Corporation. This proposed answer indicated that the Board "would be glad to be of any assistance that it can, consistent with its statutory responsibilities, to the Department of Justice and Firstamerica Corporation in any efforts to resolve the issues" involved, and that, on request of both Justice and Firstamerica, the Board would be willing to have one or more representatives of the Board meet with them to aid in identifying questions of bank supervision concerned.

The members of the Board indicated that they would approve sending the draft letter to Mr. Gesell, including, if cleared with him beforehand, a paragraph stating that a copy of his February 11 letter and the Board's reply were being sent to Justice.

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Mr. Hackley asked whether members of the Board's Legal Division should participate in any future meetings between Justice and representatives from Firstamerica and California Bank regarding matters relating to the pending litigation between Justice and Firstamerica. His understanding of the draft letter to Mr. Gesell was that the Board's offer was merely to be of assistance in matters of banking supervision. In view of the pending litigation, his judgment was that it would be preferable not to have any member of the Legal Division present in the event of such meetings.

Following discussion, it was agreed that Mr. Solomon would telephone Mr. Gesell to inquire whether he would object to the Board's making available to Justice a copy of Mr. Gesell's letter of February 11, that if he did not object the letter to Mr. Gesell would be sent and a copy also would go to Justice, and that if Mr. Gesell did not concur in this procedure the matter would be brought back to the Board. It was also understood that, in the event the letter was sent and discussions of this matter later developed between Justice, Firstamerica, California Bank, and Board personnel, representatives from the Legal Division would not participate in such meetings.

Messrs. Chase, Assistant General Counsel, and Donald Farrell, Assistant Counsel, then entered the room.

Dealer differential accounts (Items 3, 4, and 5). There had been distributed a memorandum from the Legal Division dated February 8, 1960, attaching a proposed draft interpretation of the question whether certain so-called "dealer differential accounts" set up by member banks

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When they purchase instalment paper from dealers result in the creation of deposit liabilities against which reserves must be carried. A clarifying revision of the proposed interpretation also had been distributed under date of February 16, 1960.

Mr. Hackley observed that the Board recently received inquiries from the Federal Reserve Banks of Minneapolis and Kansas City as to whether differential or "reserve" accounts set up for certain customers of member banks were deposits against which reserves were required. It appeared that there was uncertainty not only among member banks but also to some extent at the Reserve Banks as to how these accounts should be regarded, notwithstanding the fact that in 1942 the Board published a ruling (Federal Reserve Bulletin 302, F.R.L.S. No. 5900) that gave certain principles that might be used in determining their treatment. The Legal Division had prepared the draft revision of the 1942 ruling and recommended that, if it were approved by the Board, it be published in the Federal Reserve Bulletin and the Federal Register. Mr. Hackley noted that this question had been discussed with staff of the Federal Deposit Insurance Corporation with regard to coordinating the interpretation of differential accounts as deposits for assessment and reserve purposes and that they were in agreement with the proposed explanatory interpretation.

Governor Mills said that he was quite familiar with the problem and had the strong impression that the member banks and the Reserve Banks would welcome the proposed ruling.

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Unanimous approval was then given to the interpretation in the form of attached Item No. 3, with the understanding that it would be published in the Federal Reserve Bulletin and the Federal Register.

Approval also was given to letters to the Federal Reserve Banks of Minneapolis and Kansas City, responding to their inquiries of September 10, 1959 and October 9, 1958, respectively, with copies to the Federal Deposit Insurance Corporation. Copies of the letters to the two Reserve Banks also are attached as Items 4 and 5.

Messrs. Hexter, Chase, Conkling, and Donald Farrell then withdrew from the meeting and Messrs. Kiley, Assistant Director, Division of Bank Operations, and Smith, Assistant Director, Division of Examinations, entered the room.

Price Waterhouse report of audit. There had been distributed copies of the audit report covering financial statements of the Board of Governors as at December 31, 1959, and a report on scope of examination. There also had been distributed a memorandum from the Office of the Controller dated February 12, 1960, relating to the audit report. These were accompanied by draft letters to the Chairmen of the House and Senate Banking and Currency Committees that would transmit to them the audit report and the report on scope of examination, if the Board wished to continue the practice followed in recent years of sending such reports to these Committees.

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Governor Shepardson commented, in response to a question from Chairman Martin, that there appeared to be no need for representatives of Price Waterhouse & Co., the auditing firm, to be present when the Board considered the audit report, and Mr. Connell concurred.

After brief discussion, the audit report was accepted, and unanimous approval was given to the transmittal of copies to Congressman Spence and Senator Robertson, Chairmen of the House and Senate Banking and Currency Committees, respectively.

Price Waterhouse report on bank examination procedures. In connection with the audit report, Governor Shepardson noted that Price Waterhouse & Co. had submitted its report on its observations of bank examination procedures in the Federal Reserve System and that the Examinations Division was preparing a memorandum on this question.

Mr. Solomon indicated, on a question from Governor Robertson, that some time would be required for completion of this memorandum.

Depreciation accounting at Reserve Banks. Governor King asked about the status of the report by the Division of Bank Operations on depreciation accounting by the Federal Reserve Banks. Mr. Farrell replied that the Accounting Committee of the Presidents' Conference had met the week before last with Mr. Mangels, Chairman of the Committee, to consider this question and that on his (Mr. Farrell's) invitation, Messrs. Drake and Emery of Price Waterhouse had been in attendance but that Mr. Herz had been unable to attend due to illness. It was his

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understanding that Price Waterhouse was not engaged in a study of this question at the moment. Therefore, the only study being undertaken was that by the Accounting Committee. It was his belief that the Presidents of the Reserve Banks were not as far along in their views as was the Board to the effect that the depreciation accounting of the System be simplified and brought into conformity with orthodox accounting procedures. He added that he planned to use the report that would be prepared by the Accounting Committee as the basis for discussion of this question with Price Waterhouse and that the target date for final action on this question was June 30, 1960, in order to make it possible to incorporate any procedural changes agreed upon in the Reserve Bank budgets for 1961.

Messrs. Connell and Bass then withdrew from the meeting.

Certain Reserve Bank practices. Pursuant to the understanding reached at the meeting on January 29, 1960, there had been distributed under date of February 16, 1960, a memorandum from Mr. Kiley referring to the January 28, 1960, memorandum from the Division of Bank Operations presenting for the Board's consideration the proposed reply to Representative Patman's press statement of June 22, 1959. The memorandum referred to the Board's request that certain matters cited in the memorandum of January 28 be brought to its attention at a later time and that accordingly the present memorandum contained excerpts from the earlier memorandum pertaining to the practice of the Chicago

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Reserve Bank in tendering gifts, the policy of Reserve Banks regarding giving and receiving of gifts, the processing of security transactions for Reserve Bank personnel at the Minneapolis Bank, and the propriety of expenditures for dinner parties for Reserve Bank officers at the New York Reserve Bank.

Chairman Martin withdrew from the meeting at this point.

Mr. Farrell said that with respect to the question of giving and receiving gifts, there was no evidence of wrong-doing. Reserve Bank policies on receiving of gifts were substantially in line with the principle endorsed by the 85th Congress in the Code of Ethics for Government service, but they differed somewhat among the Banks. Two of the Reserve Banks, Boston and Chicago, did not permit acceptance of gifts, while the other ten Banks did not prohibit the acceptance of gifts of nominal value under varying circumstances. Of these ten Banks, Minneapolis prohibited acceptance of any gift implying an intent to influence conduct of duty and St. Louis any which might be construed as influencing conduct. At the other eight Banks, he said, members of the staff may accept gifts of insignificant value considered to be token, nominal, or inconsequential, that are usually received during the Christmas season and are made generally available. So far as the giving of gifts was concerned, the Board was familiar with the fact that Chicago was the only Reserve Bank incurring expense on this score. With respect to the purchase and sale of securities for the account of

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an officer of a Reserve Bank referred to by Mr. Patman in connection with two security purchase transactions processed by the Minneapolis Bank, Mr. Farrell recalled that the Bank had subsequently discontinued this practice, and he noted that the Kansas City Bank was the only one now permitting such transactions, following a Board request in September 1959 from the Reserve Banks for statements of policy in this regard.

So far as expenditures for dinner parties for retiring officers were concerned, Mr. Farrell referred to the discontinuance by the Minneapolis Bank of this practice. He also noted that in October 1957 a letter had been brought to the Board's attention in which the Chairman of the New York Bank advised that the directors of that Bank thought such expenditures for a new president or for resigning or retiring officers were reasonable and proper. He concluded with the observation that the question appeared to be whether the Board wished to take further action on the question of gifts.

Noting the desirability of obtaining uniformity in treatment of these questions by the Reserve Banks, Governor Robertson suggested that the best procedure might be to refer the matter to the Presidents' Conference with a request that they try to establish a justifiable basis on which gifts could be both given and received by the Reserve Banks.

Governor Mills commented on the relatively minor nature of the problem and expressed the view that, if anything more were to be done, the Reserve Bank Presidents might prefer unilateral action by the Board.

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Governor Balderston commented that there appeared to be no problem so far as receipt of gifts was concerned since no Reserve Bank would suffer embarrassment under existing procedures. In his view, the one problem consisted in the Chicago Reserve Bank's practice of making gifts.

Governor Shepardson remarked that the recent public furor concerning the taking of graft by the Chicago Metropolitan Police Department might give President Allen of the Chicago Reserve Bank the opportunity he needed to terminate that Bank's practice of making gifts.

Governor Robertson said he thought it incumbent on either the Chicago Bank or the Board--preferably the Chicago Bank--to see to it that the practice of making gifts at Bank expense was stopped. He also observed that since only the Chicago Bank was involved in gift giving, there was no reason to submit this question to other Reserve Bank Presidents.

Chairman Martin re-entered the meeting at this point, and Governor Szymczak withdrew.

There was a further discussion of the problem of gifts and whether any further action should be taken by the Board. During the discussion, Chairman Martin expressed the view that an absolute prohibition against receipt of any gifts by an officer or employee of the Reserve System was impracticable and unnecessary, and there was general

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concurrence by the other members of the Board in this comment. He went on to say that he felt the Board should be very careful not to adopt a rule now that might imply there was anything improper in existing practices in the System with respect to receipt of gifts. He was perfectly willing to stand on the present basis, he said, and he did not believe there was much to be said for going beyond the Code of Ethics for Government service, referred to earlier. If present practices did not conform to that Code, steps should be taken to bring them within it.

Chairman Martin also suggested that the System should continue to emphasize the responsibilities of the directors of the Federal Reserve Banks to see to it that expenditures of the Banks were in line with justifiable public policy. He said that there had no doubt been errors of judgment in the past, but he did not think there had been anything of an illegal nature.

The Chairman concluded with the statement that he could see no harm in a letter to the Presidents of the Federal Reserve Banks regarding this problem and there was agreement that a draft of such a letter would be prepared for the consideration of the Board.

Pan American Bank of Miami. Governor Robertson reported that Mr. Joseph S. Moss, President of the Pan American Bank of Miami, had called on him on February 16, 1960, to discuss the problems of that bank. Mr. Moss indicated agreement with the examiner's report of the

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bank's condition and was hopeful that new capital would be raised by stock issuance. If that should fail, alternatives were that funds would be borrowed from an insurance company or fruit groves or bank holdings of Sottile interests would be sold. Should no such arrangement be worked out, said Governor Robertson, it was proposed to call a meeting with supervisory officials for banks in Florida for the purpose of discussing further steps to be taken regarding this bank. In summary, Governor Robertson felt that some progress in dealing with the situation could be reported.

Thereupon all members of the staff withdrew and the Board went into executive session.

Lectures by Mr. Dembitz at Center for Latin American Monetary Studies. Following the meeting, Governor Shepardson informed the Secretary that during the executive session the Board approved his recommendation for Lewis N. Dembitz, Associate Adviser in the Board's Division of Research and Statistics, to deliver three lectures on "The Federal Reserve System" during the week beginning August 14, 1960, at the Eighth Technical Training Program of the Center for Latin American Monetary Studies, to be held in Mexico City, with the understanding that transportation expenses, plus per diem in lieu of subsistence, would be paid in accordance with the Board's travel regulations as supplemented by the Standardized Travel Regulations. The invitation for a member of the Board's staff to deliver this series of lectures was contained

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in a letter dated January 15, 1960, from the Director of the Center for Latin American Monetary Studies.

The meeting then adjourned.

Secretary's Notes: On February 18, 1960, Governor Shepardson approved on behalf of the Board the following letters:

Letter to the Federal Reserve Bank of New York (attached Item No. 6) approving the appointment of Eugene M. McGee as an examiner.

Letter to the Federal Reserve Bank of Richmond (attached Item No. 7) approving the designation of specified persons as special assistant examiners.

Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board the following items relating to the Board's staff:

#### Appointment

Florence S. Doane as Clerk (Librarian) in the Division of Personnel Administration (half-time basis), with basic annual salary at the rate of \$1,890, effective the date she assumes her duties.

#### Salary increases, effective February 21, 1960

Benjamin Berry, from \$4,534 to \$4,784 per annum, with a change in title from Foreman-Operator (Mimeograph) to Foreman-Operator, Division of Administrative Services.

Frank W. Constable, from \$6,490 to \$6,718 per annum, with a change in title from Photographer (Offset) to Foreman-Operator, Division of Administrative Services.

John Kakalec, from \$9,050 to \$9,890 per annum, with a change in title from Budget and Planning Assistant to Assistant to the Controller, Office of the Controller.

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Transfers, effective February 21, 1960

Elsie E. Anderson, Charwoman, Division of Administrative Services, from a WAE (\$1.57 per hour) basis to a full-time basis, with basic annual salary at the rate of \$2,960.

Iola B. Morgan, from the position of Secretary, Office of Defense Loans, to the position of Secretary, Division of Examinations, with no change in basic annual salary at the rate of \$5,390.

Acceptance of resignation

Rosemarie H. Smith, Clerk, Division of Personnel Administration, effective February 26, 1960.

Governor Shepardson also approved today on behalf of the Board the following items:

Memorandum dated February 17, 1960, from the Division of Personnel Administration, recommending that the trial period during which a pre-employment full-field security investigation shall be made of applicants selected to fill vacancies in sensitive positions above Grade FR-5 be continued for a third year because of insufficient experience on which to base a permanent procedure.

Letter to all members of the Board's staff advising of a program in observance of Brotherhood Week to be held on February 24, 1960, at the Interior Department, and that those employees who can be spared will be excused without charge to annual leave to attend the program.

Letter to the Federal Reserve Bank of Chicago (attached Item No. 8) approving the appointment of Laurence E. Corr as assistant examiner.

Governor Shepardson also noted today the applications of the following persons for retirement:

Gardner Lloyd Boothe, II, Administrator, Office of Defense Loans, effective March 1, 1960.

Elliott Thurston, Assistant to the Board, Board Members' Offices, effective March 1, 1960.

  
Secretary

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

Item No. 1  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 19, 1960.

CONFIDENTIAL (FR)

Mr. H. N. Mangels, President,  
Federal Reserve Bank of San Francisco,  
San Francisco 20, California.

Dear Mr. Mangels:

The Board of Governors approves the payment of salaries to the following officers of the Federal Reserve Bank of San Francisco for the period March 1 through December 31, 1960, at the rates indicated, which are the rates fixed by your Board of Directors as reported in your letter of February 4, 1960:

<u>Name</u>	<u>Title</u>	<u>Annual Salary</u>
W. G. DeVries	Assistant Cashier	\$9,500
E. A. Wells	Assistant Cashier	9,500

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

Item No. 2  
2/19/60

OFFICE OF THE CHAIRMAN

February 19, 1960.

The Honorable A. Willis Robertson, Chairman,  
Committee on Banking and Currency,  
United States Senate,  
Washington 25, D. C.

Dear Mr. Chairman:

This letter is in response to a request for comment on S. 2382, a bill "To amend the Employment Act of 1946 to provide for its more effective administration, and to bring to bear an informed public opinion upon price and wage increases which threaten economic stability." We understand the hearings also will cover S. 64, on which we commented to the Senate Banking and Currency Committee under date of February 11, 1959. Important sections of S. 2382 are similar to sections in bills submitted in 1959 and also in preceding sessions of Congress, on which the Board has already commented extensively, for example, H. R. 4870, on which the Board reported to the House Committee on Government Operations on April 1, 1959.

1. S. 2382 repeats the wording of last year's H. R. 4870 in its proposal to define the goal of maximum production as "including the concept of sustained growth," and the goal of maximum purchasing power as "including the concept of reasonable price stability." Both goals appear to the Board to be implicit in the present Act. The Board's view is that sustained growth cannot be divorced from reasonable price stability. An economy characterized by the latter, with individual prices reflecting the changing patterns of supply and demand and of saving and investment in a free market economy, seems to the Board clearly to offer the best environment for sustained economic growth.

The Honorable A. Willis Robertson

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Over the past year, public discussion of stable prices and sustained growth--in which Congressional committees have played a leading role--has been intensified. Concurrently, a great deal of effort has gone into adding to and clarifying our knowledge of these issues. Our view, as in the past, is that, while not essential, it would be desirable to make these goals explicit, although the exact wording of any amendment needs careful consideration.

2. S. 2382 also repeats the provisions of H. R. 4870 requiring the President to include in each year's Economic Report, in quantitative terms, the levels of employment, production, and purchasing power which he deems "maximum," and current and foreseeable trends. The present Act is somewhat ambiguous with respect to quantitative terms.

The Board is not in favor of a requirement that an explicit forecast, in quantitative terms, be presented each year for employment, production, and purchasing power. Projections in quantitative terms are, of course, important aids to economic analysis and to policy formation. Publication in quantitative terms of the Council's views of prospective economic developments, however, is another matter. It might easily, given the present stage of economics, hinder rather than expedite the adaptation of policy to changing circumstances. It could, unfortunately, entrench positions and divert effort from the necessary process of review and adaptation to the polemics of attack on and defense of numbers.

3. The provisions of S. 2382 relating to price and wage increases which appear to threaten economic stability incorporate some improvements over preceding bills. It is an improvement that the selection of the price or wage increases to be investigated and publicized under this provision is left to the judgment of the President, and also that the President may designate a Federal agency other than the Council to hold hearings. Nevertheless, basic issues remain that prompt the Board to question the desirability of this segment of the bill. To be meaningful, it would put the Government into the business of price and wage determination. The Government would be forced to operate on fundamental and far-reaching issues without adequate criteria. For the President, or an agency designated by him, to set forth detailed wage and price standards on a recurrent basis would be a drastic step for a free enterprise economy in peacetime. Under such circumstances, national efforts

The Honorable A. Willis Robertson

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to determine price and wage increases that do, or do not, threaten national economic stability, to arrive at the necessary recommendations, and to get these recommendations accepted would undoubtedly open a Pandora's box of arguments, of claims and counterclaims difficult, if not impossible, to evaluate.

4. The Board is concerned with the provisions of S. 2382 which would commit the President to incorporating, in the program recommendations of the Economic Report, recommendations on monetary and credit policies "to the same extent as all other policies affecting employment, production, and purchasing power." Furthermore, the bill provides that "if the Federal Reserve Board disagrees . . . the President in his report to the Congress shall include the Board's views and reasons." In essence, these provisions were included in H. R. 4870, and the Board commented extensively on them in a letter to the Hon. William L. Dawson, Chairman, Committee on Government Operations, House of Representatives, dated April 1, 1959.

The Board continues to believe that proposed changes of this kind in the Employment Act are undesirable on the grounds that they are both unnecessary and capable of generating mischievous consequences--whether through hampering the flexibility essential to the Federal Reserve in adapting monetary and credit policies to changing conditions, or through stimulation of speculative tendencies in the use of bank credit. The proposed changes, furthermore, are contrary in spirit both to the legislative foundation and the subsequent development of the Federal Reserve System.

The Board's policy decisions are made on the basis of continuous scrutiny of the complex of economic forces, non-financial as well as financial, and there is the fullest possible disclosure of the information on which decisions are made. The Board endeavors to keep in close touch with the Executive offices of the Government, and there is ample opportunity for exchange of views. It may be noted that the Chairman has appeared in recent years before the Joint Economic Committee to testify on the President's Economic Report. Testimony on behalf of the Board before committees of Congress frequently has stressed monetary and credit developments and their relationship to policy.

The Honorable A. Willis Robertson

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Congress has heretofore entrusted to the Federal Reserve System responsibilities for decisions in the area of monetary and credit policy. A separate mandate from the Congress to the Executive, as contained in this bill, to make recommendations in this area and to report to the Congress differences between him and the Federal Reserve would--we believe--jeopardize the ability of the System, as an agent of Congress, to perform its duties and responsibilities in an independent, objective, non-partisan, and impartial manner. There can be no doubt that the Congress at any time can limit or withdraw the trusteeship it has granted to the Federal Reserve System to carry out constitutional responsibilities of Congress in the field of money and credit. However, any action that might reduce the independence of the Federal Reserve from the Executive should be considered with great care--in the context of hearings and studies devoted primarily to this subject.

For these various reasons, the Board does not favor the enactment of S. 2382.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

"Differential" Account as A Deposit Against which Reserves  
Are Required Under Regulation D

The Board has recently received several inquiries as to whether certain differential or reserve accounts set up for installment paper are deposits against which reserves are required. In 1942 Federal Reserve Bulletin 302, F.R.L.S. #5980, the Board stated four conclusions for determining whether so-called "dealer reserve" or "differential" accounts are deposits against which reserves are required:

"1. If the purchase price of the paper is credited to the dealer's account, the resulting credit obviously is a deposit against which reserves must be maintained.

"2. The uncollected difference between the purchase price and the face amount of the paper is in practical effect a potential margin of security and does not constitute a deposit against which reserves must be maintained.

"3. Where, however, an installment payment has been received and a portion of such payment (say 90 per cent) has been credited against the purchase price and the remainder (say 10 per cent) has not been credited against the purchase price, the 90 per cent of the payment which has been applied against the purchase price does not constitute a deposit balance, but the remaining 10 per cent of the payment does constitute a deposit unless and until it is paid over to the dealer or applied against his indebtedness.

"4. Whenever the payments received on any paper purchased aggregate an amount in excess of the purchase price plus interest or discount, any such excess which is not paid over to the dealer or credited against his indebtedness likewise constitutes a deposit against which reserves must be maintained."

There apparently is doubt among some member banks as to the situations in which these various conclusions are applicable. In the interests of clarification, the Board wishes to point out and differentiate typical circumstances in which each of the above conclusions would be controlling.

Conclusion No. 1 would be controlling in a situation where the borrower is credited with the full face amount or outstanding balance of the paper but a certain percentage thereof is designated

as a reserve account and cannot be withdrawn by the dealer. In such a case the entire amount credited to the dealer's account, including the percentage of the purchase price withheld, constitutes a deposit against which reserves are required. The fact that no repayments on the paper have been received and held in the account is not material in determining whether the account is a deposit. The determining factor is that the reserve is created out of the proceeds of the full purchase price of the paper.

By contrast, the differential account under Conclusion No. 2 is created from the uncollected difference between the purchase price of the paper and the face amount or outstanding balance thereof. In this case, the differential account would merely be a memorandum of this "uncollected difference" and constitute a potential margin of safety for the purchaser of the paper. Under these circumstances, the differential account would not constitute a deposit against which reserves are required.

Conclusion No. 3 applies to those situations where collections are received in a differential account. Obviously, any portion of such collections which is credited against the purchase price does not constitute a deposit. However, any portion of such collections which is carried in the differential account and is not applied against the purchase price or otherwise paid over to the dealer, constitutes a deposit against which reserves are required. In some instances, the entire amount of the collections when received is held in the differential account for a period of time. Periodically, a portion of the collections is offset against the purchase price. Until the collections are either paid over to the customer or applied against his indebtedness, they constitute deposits against which reserves are required.

Conclusion No. 4 also applies to those situations where collections are received on instalment or similar paper. It is emphasized in this conclusion that all payments received on paper in excess of the purchase price plus interest, discount, and the like, which are not applied against the borrower's indebtedness or otherwise paid over to him, are deposits against which reserves are required. This would be true regardless of how this excess is held by the bank, whether in a differential account or otherwise.

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

Item No. 4  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 23, 1960.



Mr. Frederick L. Deming, President,  
Federal Reserve Bank of Minneapolis,  
Minneapolis 2, Minnesota.

Dear Mr. Deming:

This is in reply to your letter of September 10, 1959, relative to whether certain reserve or differential accounts carried by member banks are deposits for which reserves must be maintained under Regulation D.

As you know, in a ruling on this general subject published in 1942 Federal Reserve Bulletin 302 (F.R.L.S. #5980), the Board reached four "conclusions" to aid in determining what constitutes deposits against which reserves are required.

"1. If the purchase price of the paper is credited to the dealer's account, the resulting credit obviously is a deposit against which reserves must be maintained.

"2. The uncollected difference between the purchase price and the face amount of the paper is in practical effect a potential margin of security and does not constitute a deposit against which reserves must be maintained.

"3. Where, however, an instalment payment has been received and a portion of such payment (say 90 per cent) has been credited against the purchase price and the remainder (say 10 per cent) has not been credited against the purchase price, the 90 per cent of the payment which has been applied against the purchase price does not constitute a deposit balance, but the remaining 10 per cent of the payment does constitute a deposit unless and until it is paid over to the dealer or applied against his indebtedness.

"4. Whenever the payments received on any paper purchased aggregate an amount in excess of the purchase price plus interest or discount, any such excess which is not paid over to the dealer or credited against his indebtedness likewise constitutes a deposit against which reserves must be maintained."

Mr. Frederick L. Deming

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The effect of these conclusions, as applied to different situations, may be summarized as follows: Where dealer paper is purchased for its face value and a certain amount thereof is "held back" by the bank, this "holdback" or reserve account is a deposit against which reserves are required. On the other hand, where the purchase price of the paper is less than the face value thereof, this uncollected difference constitutes a differential account which is a potential margin of security for the bank, against which reserves are not required. However, this differential account has reference to the uncollected difference between the purchase price and the face amount of the paper. Where payments are received on the paper and held against the differential account without being paid over to the customer or applied against his indebtedness, these payments received and held constitute deposits against which reserves are required under Regulation D.

The situations described in your letter are of a somewhat general nature and this reply is therefore necessarily based upon certain assumptions relative to the purchase price of the paper and payments made thereon.

In the first situation described in your letter, "holdbacks of reserve funds [are] set up in connection with discounted paper pursuant to a written agreement with the dealer". Assuming this refers to a situation in which a percentage of the purchase price of the paper is "held back" by the bank, this "holdback" or reserve account constitutes a deposit against which reserves are required. For the sake of clarification, this situation is to be distinguished from one in which reserves would not be required where the "holdback" constituted merely a memorandum of the uncollected difference between the purchase price and the face amount of the paper.

The second situation described in your letter would not technically be considered a reserve or differential account situation. However, the factors involved are of a similar nature and of the same effect for the purpose of computing reserves under Regulation D. In this situation "collections of assigned accounts receivable [are] held as collateral for commercial loans". Periodically, these collections are offset against the outstanding loans. However, it appears that this "collections-received account" remains outstanding for that period of time between the date on which the collections are made and the date on which they are periodically offset against the outstanding loan. During this time when the collections are not either paid over to the customer or applied against his indebtedness, they constitute deposits against which reserves are required under the regulation.

Mr. Frederick L. Deming

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In the third situation described in your letter, Sears-Roebuck and other large firms discount conditional sales contracts "under an arrangement whereby an amount equal to 10% of each monthly batch is held by the bank as a so-called reserve from which defaults may be deducted". It is our understanding that Sears sells these contracts at 90 per cent of their face amount. The 10 per cent uncollected difference between the purchase price and the face amount of these contracts constitutes a differential account against which reserves are not required. However, collections made against this differential account would constitute deposits against which reserves are required unless they are promptly paid over to the customer or applied against his indebtedness.

For your information, there is enclosed a copy of an interpretation by the Board which will be published in the Federal Reserve Bulletin and the Federal Register, clarifying the application of the "conclusions" set forth in 1942 Federal Reserve Bulletin 302.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.

Enclosure

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

Item No. 5  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 23, 1960.



Mr. H. G. Leedy, President,  
Federal Reserve Bank of Kansas City,  
Kansas City 6, Missouri.

Dear Mr. Leedy:

This is in reply to Mr. Woolley's letter of October 9, 1959, to Mr. John R. Farrell, with enclosed correspondence between your Bank and The Central Bank and Trust Company, Denver, Colorado, concerning the question whether certain Dealers Differential Accounts held by The Central Bank and Trust Company are deposits against which reserves must be carried.

Included in the enclosed correspondence was a memorandum of Mr. Hal Roof, Vice President of the member bank, stating that the "reserves are created only by accepting the face amount or unpaid balance of the notes pledged and advancing a predetermined percentage of this amount". The reserves thus created ranged from 3 per cent to 20 per cent of the unpaid balance of the bank loan. In each instance, any excess over the required amount is credited monthly to the dealer's account.

The letter states that the member bank was referred to the Board interpretations, S-81 dated March 22, 1938, and S-441 dated February 21, 1942. The 1938 ruling considered a situation in which certain amounts were set aside in a special reserve account to meet possible losses on loans. It is stated therein that the bank "... makes an arrangement with an automobile dealer or other similar dealer to discount his contracts with the understanding that out of the proceeds of each contract a certain amount will be set aside in a reserve fund and not paid to the dealer until the contract from which it arose is paid in full; . . ." (Emphasis added.) It is emphasized that the reserve fund in the 1938 ruling was set aside out of the proceeds of the contract price. The reserve account in that situation was held to constitute a deposit against which reserves were required.

Mr. H. G. Leedy

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The 1942 ruling stated four "conclusions" to aid in the determination of deposits against which reserves are required. The first conclusion stated:

"1. If the purchase price of the paper is credited to the dealer's account, the resulting credit obviously is a deposit against which reserves must be maintained."

This conclusion would be applicable to the situation covered by the 1938 ruling. In that case, the full amount of the purchase price was credited to the dealer's account but a certain percentage thereof was designated as a reserve account and could not be withdrawn by the dealer. As required by the above conclusion, the entire amount credited to the dealer's account, including that percentage of the purchase price withheld is a credit which constitutes a deposit against which reserves are required.

The second conclusion in the 1942 ruling states that:

"2. The uncollected difference between the purchase price and the face amount of the paper is in practical effect a potential margin of security and does not constitute a deposit against which reserves must be maintained."

This second conclusion applies only where the purchase price of the instalment paper is less than the face value of the paper so that, as explained in the 1942 ruling, ". . . the so called differential account constitutes merely a current record of the excess of the unpaid balance of the face amount of the paper over the unpaid balance of the agreed purchase price". However, when payments are received and held in such a differential account, and are not promptly credited to the dealer's account or otherwise paid over to him, such payments received and held are deposits against which reserves are required.

It is not clear from the attached correspondence whether the differential accounts of The Central Bank and Trust Company of Denver would be governed by Conclusion No. 1 or Conclusion No. 2 of the 1942 ruling. If the differential account of the member bank were created by withholding a percentage of the proceeds from the purchase price of the paper, the so-called reserve account would constitute a deposit against which reserves are required. On the other hand, if the purchase price of the paper were less than the face amount or unpaid balance of the paper, so that the differential account was merely a memorandum of the difference between the purchase price and the face

Mr. H. G. Leedy

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amount of the paper, then Conclusion No. 2 would apply and reserves would not be required against the differential account except to the extent that payments were actually received and held in the account. It is emphasized that in cases covered by Conclusion No. 2, once collections on the paper are received and held in the differential account, such collections become deposits against which reserves are required.

Regarding the question of penalties, it is the Board's understanding that no penalties are involved if Conclusion No. 2 is reached. If your Bank determines that the differential accounts of The Central Bank and Trust Company of Denver are governed by Conclusion No. 1, the bank should be informed that reserves must be maintained against such accounts following the date of such determination. However, the Board authorizes your Bank to waive the penalties that would have been incurred on the basis of this determination during prior reserve computation periods. Merely for statistical information, it is suggested that the bank be asked to reconstruct its reserve reports for three or four sample reserve computation periods since February 1958.

For your information, there is enclosed a copy of an interpretation by the Board which will be published in the Federal Reserve Bulletin and the Federal Register, clarifying the application of the "conclusions" set forth in 1942 Federal Reserve Bulletin 302.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.

Enclosure

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

Item No. 6  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 1960.

Mr. John F. Pierce, Chief Examiner,  
Federal Reserve Bank of New York,  
New York 45, New York.

Dear Mr. Pierce:

In accordance with the request contained in your letter of February 10, 1960, the Board approves the reappointment of Eugene M. McGee, at present a special examiner, as an examiner for the Federal Reserve Bank of New York. The authorization heretofore given your Bank to designate Mr. McGee as a special examiner is hereby canceled. Please advise as to the salary rate and date on which the reappointment is made effective.

It is noted that Carl H. Allen and John J. Hoch are being transferred to the Bank Relations Department for a rotational training period of approximately 12 to 18 months, and that their commissions as examiners for your Bank are to be retained.

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. 7  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 18, 1960.



Mr. N. L. Armistead, Vice President,  
Federal Reserve Bank of Richmond,  
Richmond 13, Virginia.

Dear Mr. Armistead:

In accordance with the request contained in your letter of February 10, 1960, the Board approves the designation of the following named employees of your Bank as special assistant examiners for the Federal Reserve Bank of Richmond for the purpose of participating in the examination of banks except the institution indicated immediately above their names:

State-Planters Bank of Commerce and Trusts  
Richmond, Virginia

G. N. Campbell

The Catonsville National Bank  
Catonsville, Maryland

O. Ridgely Flohr

Bank of Charlotte (Nonmember)  
Charlotte, North Carolina

Jack C. Starnes      D. Maynard Marshall, Jr.

American Commercial Bank  
Charlotte, North Carolina

T. Wesley Bagby

First Union National Bank of North Carolina  
Charlotte, North Carolina

Herman C. Yaeger

Robert E. Sing

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. N. L. Armistead

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The Bank of Commerce (Nonmember)  
Charlotte, North Carolina

Perry J. Churchwell, Jr.

The Bank of Virginia  
Richmond, Virginia

Luther Flippen      Clarence E. Proffitt

First and Merchants National Bank of Richmond  
Richmond, Virginia

John E. Broskie

St. James Savings Bank of Baltimore City (Nonmember)  
Baltimore, Maryland

Irvin J. Crowl

The Central National Bank of Richmond  
Richmond, Virginia

Luther Flippen

Virginia Trust Company (Nonmember)  
Richmond, Virginia

Clarence E. Proffitt

The Bank of Henrico (Nonmember)  
Sandston, Virginia

John E. Broskie

Provident Savings Bank (Nonmember)  
Baltimore, Maryland

Irvin J. Crowl

The authorizations heretofore given your Bank to designate the above named individuals as special assistant examiners are hereby canceled.

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. 8  
2/19/60

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 19, 1960.

Mr. W. R. Diercks, Vice President,  
Federal Reserve Bank of Chicago,  
Chicago 90, Illinois.

Dear Mr. Diercks:

In accordance with the request contained in your letter of February 15, 1960, the Board approves the appointment of Laurence E. Corr as an assistant examiner for the Federal Reserve Bank of Chicago. Please advise as to the date on which the appointment is made effective.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,  
Assistant Secretary.