

Minutes for November 1, 1960

To: Members of the Board

From: Office of the Secretary

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

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin

Gov. Szymczak

Gov. Mills

Gov. Robertson

Gov. Balderston

Gov. Shepardson

Gov. King

The image shows handwritten initials and signatures on lines next to the names of the board members. The initials are: Chm. Martin (RM), Gov. Szymczak (WZ), Gov. Mills (MS), Gov. Robertson (R), Gov. Balderston (CB), Gov. Shepardson (SS), and Gov. King (K). There is a large, stylized signature that spans across the lines for Gov. Szymczak, Gov. Mills, and Gov. Robertson.

Minutes of the Board of Governors of the Federal Reserve System on
 Tuesday, November 1, 1960. 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. Kenyon, Assistant Secretary
 Mr. Hackley, General Counsel
 Mr. Solomon, Director, Division of Examinations
 Mr. Conkling, Assistant Director, Division of
 Bank Operations
 Mr. Landry, Assistant to the Secretary

Mr. Ray M. Gidney, Comptroller of the Currency, also was present,
 along with Messrs. Jesse P. Wolcott, Chairman, Erle Cocke, Director, and
 Neil G. Greensides, Acting Assistant to the Chairman, Federal Deposit
 Insurance Corporation.

Absorption of exchange charges. Pursuant to the understanding
 reached at the Board meeting on October 27, 1960, this meeting had been
 arranged for the purpose of considering the problem of absorption of
 exchange charges, particularly in the light of the Board's ruling of
 August 4, 1960, and subsequent developments, including the proposals
 submitted by the Bank Management Commission of the American Bankers
 Association, the Association of Reserve City Bankers, and other parties
 for modification of the August ruling.

Governor Robertson opened the discussion by outlining and
 commenting upon four alternatives that had been considered by the Board,
 as follows:

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- (1) Adherence to the ruling of August 4, 1960.
- (2) Adoption of the proposal of the Bank Management Commission and the Association of Reserve City Bankers which would permit member banks to absorb exchange of up to five cents on any one nonpar item and also would permit the absorption of a maximum of \$2 per month for any one customer.
- (3) Restoration of the \$2 rule, with perhaps an increase in the amount per month permitted to be absorbed.
- (4) Adoption of a position similar to that taken by the Federal Deposit Insurance Corporation under which absorption of exchange charges would not be considered as payment of interest on deposits unless examination of a particular bank indicated that such absorption represented compensation to a depositor for the use of funds.

Governor Robertson then referred to information that he had received from certain sources regarding the effect of adopting the proposals of the Bank Management Commission and the Association of Reserve City Bankers in terms of the percentage of exchange charges, in dollars, that member banks would be able to absorb. He also noted that the New York Clearing House had advised that it was in the process of making a study over a 30-day period to obtain information on the handling of nonpar items by its member banks. This led him to suggest that a fifth alternative procedure might be to suspend the August 4 ruling, or to keep it in effect, while conducting a factual study. Such a study could be conducted by each Federal Reserve Bank in company with local representatives of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, and in cooperation with representatives of the American Bankers Association,

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the Association of Reserve City Bankers, and NABAC, the Association for Bank Audit Control and Operation. On the basis of the study, which could be conducted for a limited period at representative banks in each Reserve District, it might be possible for the three Federal bank supervisory agencies to devise a rule that would be acceptable and enforceable and would receive the support of the banking profession.

Mr. Gidney indicated that he would not consider it advisable for the Board to retain the present rule or to change to a position similar to that of the Federal Deposit Insurance Corporation. In a matter of this kind, he suggested, it is necessary to have allies, and he would not rule the plan of the Bank Management Commission completely out of consideration at this time. However, he felt that there was a need to have more adequate factual information on which to base a decision. Therefore, while the elimination of the \$2 rule appeared to have been the step that resulted in the most dissatisfaction, it might be considered preferable, after studying the results of a survey, to go all the way to the proposal of the Bank Management Commission.

There followed discussion of the type of survey that would be envisaged if the procedure suggested by Governor Robertson were agreed upon, and of the time that might be required for completion of such a survey.

Governor Mills then stated that he had come out in his thinking close to the point of view expressed by Mr. Gidney. Going back over the

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years, there had been so many inconsistencies in attempting to define the payment of interest that one problem seemed simply to lead to another. When it came to the absorption of exchange charges, the more he listened to the discussion the more it seemed to him that the problem was really one of obtaining general cooperation from the persons affected. There appeared to be a strong factor of self-interest on the part of par banks, who did not want to be put to the cost of absorbing exchange charges to any large extent. Therefore, there would seem to be a possibility of getting widespread cooperation of member banks in accepting a ruling that would be workable but would not go as far as the proposals of the Bank Management Commission and the Association of Reserve City Bankers. Restoration of the \$2 rule would eliminate the irritation involved in charging back trivial amounts to a large number of accounts. Even though this step might not correct the problem in respect to some of the larger accounts, it appeared to be the feeling of a number of the Reserve Bank Presidents that if the Board went back to the \$2 rule, or perhaps raised the figure to \$3 or \$4, it would be possible to correct a major part of the problem and at the same time obtain broad cooperation of the banks who did not want to find themselves in the position of having to absorb a great deal of exchange. Accordingly, one possibility would be to restore the \$2 rule for a reasonable period of time during which a study could be made. In any such study, of course, the banks might be tempted to come up with results

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pointing toward acceptance of the formula of the Bank Management Commission, which formula might not actually provide the right answer.

Mr. Cocke agreed that it was necessary to approach the problem in a practical way and obtain the cooperation of the banking profession. An arbitrary ruling would be undesirable and capitulation would be worse. Accordingly, he would favor a study of the kind that had been proposed, since it would provide information that might make it easier to reach a decision that would be both practical and reasonable. In his opinion, it would be better if the problem could be worked out on a mutually acceptable basis without seeking new legislation, which suggested that key people from the banking profession should be tied into the study so that they would understand and support whatever decision was made. For this reason, he proposed soliciting the cooperation of key people in the American Bankers Association, the Association of Reserve City Bankers, and NABAC. A limited survey on a spot-check basis would, he felt, be just as satisfactory in developing essential facts as a survey covering a large number of banking institutions. Only a small percentage of the top officers of banks were fully acquainted with the details involved in the handling of nonpar items, and the objective of a survey should be to get sufficient factual information so that key persons in the representative banking organizations could size up the situation and be in a position to lend their support to whatever decision might be made by the bank supervisory agencies.

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After further discussion based on the thoughts expressed by Mr. Cocks, Mr. Gidney verified, in response to a question by Chairman Martin, that his preference would be to restore the \$2 rule and announce that it would be in effect until such time as a study could be completed and a final determination made. In support of announcing a return to the \$2 rule on a temporary basis, he expressed the view that this would be necessary to gain the support of the banking fraternity while the study was being made.

Governor Robertson indicated that he would go along with an approach to the problem under which a survey would be launched in order to obtain the facts on which to arrive at a permanent rule on which all of the bank supervisory agencies could agree. Such an approach would contemplate that in the period until the study was completed the \$2 rule would be restored. It would be hoped that the study could be completed within a period of perhaps three months, and when a final determination was made the same degree of enforcement by each supervisory agency would be expected.

Question was raised regarding the possibility of enforcement during the interim period, and in this connection Governor Shepardson inquired whether it might be better to suspend the Board's outstanding ruling until the proposed survey could be completed and a decision reached. Mr. Gidney commented that it would be undesirable to encourage additional banks to begin making exchange charges and that it was the elimination of

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the \$2 rule that seemed to create the greatest dissatisfaction on the part of the banks. Governor Robertson commented that restoration of the \$2 rule would permit those banks who would like to go along with the supervisory agencies to hold their position, provided the restoration of the \$2 rule was announced as being on a temporary basis pending a final determination of the problem. In other words, some support might be retained that would otherwise be lost. As Mr. Gidney had pointed out, a suspension of the August ruling might provide an incentive to the charging of exchange by additional banks, the sending of nonpar items to other banks for absorption of exchange charges, or the solicitation of accounts on the basis of a willingness to absorb exchange. Mr. Cocke suggested that suspension of the August ruling might create an unfortunate impression regarding the impact of the protests that had been made concerning it, while restoration of the \$2 rule might convey an impression of compromise.

At this point Mr. Greensides made certain comments in which he indicated concern about getting into the detailed costs of banks in respect to the absorption of exchange, while at the same time banks were furnishing services for customers, such as armored car service, that were likewise costly.

Governor Robertson acknowledged the existence of a problem in trying to differentiate between the absorption of exchange charges and the providing of various services. To the extent that rulings on the

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absorption of exchange charges merely set up a protection for banks that did not want to absorb exchange, the situation was not desirable. If the Board were to reverse its position completely, the banking system as a whole probably would object strenuously, but the question might be asked whether there was any good reason why each bank should not have to decide for itself whether to absorb exchange charges. On the other hand, it might be hoped that restriction of the absorption of exchange charges would work in the direction of the elimination of non-par banking.

Governor Mills noted that member banks appeared to have accepted the portion of the August ruling which prohibited maintaining balances with nonmember banks in order to effect indirect absorption of exchange charges. In the circumstances, it occurred to him that there might be a reason for the Federal Reserve to make some concession on the portion of the ruling relating to direct absorption. This led him to suggest again the possibility of increasing to \$3 per month or some other figure the maximum amount of exchange that could be absorbed for any one customer. The \$2 rule was instituted in 1945, and since that time the volume of business handled by banks had vastly increased, so it might be assumed that the \$2 rule, when first adopted, gave about as much relief as a \$3 rule would provide at the present time.

Mr. Gidney suggested that it might be better not to go higher than \$2 until after the proposed study was made and evaluated, and

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Governor Shepardson also expressed the thought that it might not be desirable to adopt any new approach while the study was in progress.

Governor Robertson inquired whether it was understood that there would be enforcement of the \$2 rule by the Federal Reserve and the Comptroller's Office if the Board should decide to reinstate that rule during the period when the proposed study was in progress and pending the establishment of a permanent rule, and Mr. Gidney indicated that this would be his understanding.

Chairman Martin then commented that there appeared to be rather general agreement on making a survey and reinstating the \$2 rule pending the completion of the study. He added that if it then developed that no workable solution could be found, the alternatives might be to capitulate or to go to the Congress for new legislation. He was not suggesting capitulation, but if a solution to the problem could not be found under the present legislation, the only alternative to capitulation might be to request new legislation.

After further discussion relating to procedural steps incident to announcing the proposed study, Mr. Greensides suggested that it might be preferable not to indicate that it was hoped to complete the study within any specified period of time because the time required to reach conclusions might be longer than one would anticipate.

Governor Robertson then summarized his understanding of the contemplated procedure as follows. The three Federal bank supervisory agencies

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would cooperate in conducting the study, but no time limit for the completion of the survey and the reaching of a final determination would be stated. The details of the survey in each Federal Reserve District would be left to the President of the Federal Reserve Bank and the local representatives of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, including the selection of the banks in the District that would be asked to participate. In making the survey, the support of the American Bankers Association, the Association of Reserve City Bankers, and NABAC would be sought.

There was no indication of dissent from the procedures outlined by Governor Robertson.

Question then was raised by Mr. Cocke regarding the possibility of having legal representatives of the three supervisory agencies confer for the purpose of studying legal aspects of the absorption of exchange charges in relation to the payment of interest on deposits, but after discussion it was the consensus that such interagency consultations might be more profitable if deferred until after the results of the contemplated survey were available.

Agreement was expressed with the suggestion that advice of a decision to undertake the survey and restore the \$2 rule temporarily should be given to the Chairman of the Bank Management Commission and the President of the Association of Reserve City Bankers.

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It was then agreed that drafts of an interpretation and other documents reflecting the procedure decided upon at this meeting would be submitted to the Comptroller of the Currency and the Federal Deposit Insurance Corporation for comments and suggestions, and that in the light of such comments and suggestions the matter would be considered by the Board.

Messrs. Gidney, Wolcott, Cocke, and Greensides then left the room and Messrs. Young, Adviser to the Board, Shay, Legislative Counsel, Molony, Assistant to the Board, and Solomon, Chief, Capital Markets Section, Division of Research and Statistics, joined the meeting.

Reply to letter from Senator Gore (Item No. 1). In a letter to Chairman Martin dated October 27, 1960, Senator Gore of Tennessee raised certain questions relative to the amendments to Regulation D, Reserves of Member Banks, announced by the Board on October 26. A draft of reply had been distributed to the members of the Board prior to this meeting.

Several suggestions were made with regard to the tone and construction of the proposed reply, but the content of the draft was regarded as generally appropriate. It was then understood that the draft would be studied further by the staff in the light of these suggestions and that the reply to Senator Gore would be sent in a final form satisfactory to Chairman Martin. A copy of the letter sent in accordance with this understanding is attached to these minutes as Item No. 1.

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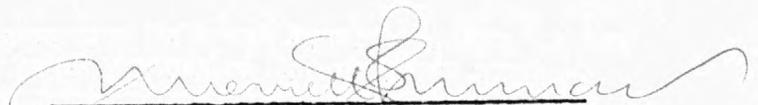
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Discount rates. The establishment without change by the Federal Reserve Banks of Boston and Atlanta on October 31, 1960, of the rates on discounts and advances in their existing schedules was approved unanimously, with the understanding that appropriate advice would be sent to those Banks.

Open market matter. Consideration was given to a question relating to the exchange of System Open Market Account holdings in connection with the refunding of Treasury securities maturing in mid-November, concerning which appropriate information has been placed in the files of the Federal Open Market Committee.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board a memorandum dated October 26, 1960, from Mr. Kelleher, Director, Division of Administrative Services, recommending the appointment of Eugene Edward Bishop as Guard in that Division, with basic annual salary at the rate of \$3,500, effective the date of entrance upon duty.


Secretary



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 1
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OFFICE OF THE CHAIRMAN

November 1, 1960

The Honorable Albert Gore
United States Senate
Washington 25, D. C.

Dear Senator Gore:

Thank you for your letter of October 27 regarding the Board's announcement of October 26 of amendments to Regulation D, relating to bank reserves and reserve requirements, that will become effective November 24 and December 1, 1960.

The action will have the two-fold effect of:

1. Making available to the System's 6,200 member banks about \$1,300 million of additional reserves as the economy enters, between Thanksgiving and Christmas, the peak season of rising cash and credit needs.
2. Supplementing the Board's two previous actions of December 1959 and August 1960 to implement the Act of Congress relating to vault cash and reserve requirements that became law on July 28, 1959.

Your letter recognized that the economy has very large additional needs for currency and bank loans in the season preceding Christmas, and I feel sure that you are as anxious as we to see that those needs are met, and that there can be no disagreement between us on that.

As was made known here in response to press inquiries, the Federal Reserve intends to make ample provision for whatever need there actually develops for bank reserves in the period between now and the end of the year. This will unquestionably entail providing reserves through open market operations in addition to those made available by adjustments announced October 26.

Perhaps you will find the enclosed copy of our announcement helpful in connection with the matters in which you are interested, but I should like also to respond serially to the three questions you raised.

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First, as to announcement of the action in advance of the effective date. Changes in the Regulation governing the counting of vault cash and the level of reserve requirements involve adjustments in the operating procedures of member banks for which advance notice is helpful, and desirable when circumstances permit. The desirability of advance notice is all the greater when the amount of reserves to be released is large, and the release accordingly is to take effect in two or more steps. Thus, a similar vault cash and reserve requirement action in implementation of the 1959 legislation was announced August 8, 1960, to take effect August 25 and September 1, which made available about \$600 million of additional reserves in two steps timed to meet the rise in credit needs that begins as autumn approaches. The action announced October 26, to release \$1,300 million in two steps, effective November 24 and December 1, was in the same pattern.

Your second point appears to have two parts.

In the first part, belief is set out that the bank reserves provided for in the October 26 action by the Board should have been provided, instead, by the purchase of Government securities. It is important to bear in mind that the Board's action was taken to implement an Act of Congress. In order to implement that legislation, action of this nature had to be taken at some time. The large seasonal needs in the period ahead made the timing chosen appropriate, as did economic circumstances.

The last part of your second point appears to be concerned with relating the gold outflow to the interest rate on Treasury bills and relating the rate on bills, in turn, to operating procedures of the Open Market Committee of the Federal Reserve System.

The gold outflow to which you refer must be considered in the perspective of our entire balance of payments position. We have been running a balance of payments deficit, at an annual rate approximating \$3 billion, despite the fact that we have a considerable surplus of exports over imports. This deficit is due to the fact that the trade surplus has not been sufficient to cover our large commitments for foreign aid and a movement of capital that has been particularly heavy this year. The capital outflow is due to many factors. One, although certainly not the most important, has been the prevalence in the United States of a level of interest rates that in all sectors of the market -- short, intermediate and long -- is lower than the level of interest rates in other major countries. The October issue of the Federal Reserve Bulletin contains an article on recent balance of payments developments which covers these matters in some detail. A copy of that article is enclosed.

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That brings us to the question you raise as to whether interest rates in general, and the bill rate in particular, would be affected differently if the needed reserves were supplied by purchasing Government securities, more especially intermediate bonds, rather than by the release of reserves provided for in the October 26 action of the Board.

The impact on market rates, short-term or intermediate, of any provision of additional reserve funds is complicated. The direct impact on interest rates of open market operations, in our experience, is least when those operations are conducted in the bill sector because of the large volume of trading which regularly characterizes this sector. However, the secondary and indirect effects on market interest rates of a new supply of reserve funds are much greater than any direct effects, and they tend to be the same as a general rule regardless of the method by which the reserve funds are supplied.

With regard to this particular action, the question of direct and indirect effects on interest rates could hardly be an issue. The purpose of providing additional reserve funds at this time is to meet seasonal demand pressures for bank credit and currency that otherwise might have had the temporary effect of raising interest rates and lowering security prices. In view of the nature of the market pressures, it was deemed desirable to make funds available to the banking system by means of a reserve requirement adjustment.

The purchase of anything like a billion dollars of intermediate- or long-term securities in the open market in a relatively short period would, in my judgment, have most unfortunate repercussions. The current volume of trading in these maturities is very small in relation to the magnitudes traded in the bill market, and both the substantive and psychological effects of System intervention in these markets would be very likely to induce unsustainable rate movements which would discourage private trading and tend to destroy the market completely over a period of time. For these reasons, not because of any predetermined "bills-only policy", I sincerely believe that it would have been, and would be, a major error of monetary management to attempt to provide for seasonal reserve needs through purchases of intermediate and longer term issues.

Perhaps I should note that the term "bills-only policy" is in truth a misnomer that has misled many persons as to the real nature of the operating procedure actually followed. The text of the pertinent part of the Open Market Committee's procedural statement reads as follows:

"Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further actions of the Federal Open Market Committee."

Now to your third and final point, whether the October 26 action to reduce reserve requirements for central reserve city banks, coupled with an increase to be made in reserve requirements for country banks, is contrary to the spirit of the vault cash provision of the 1959 Act and is "clearly discriminatory in favor of a few large banks and against the many, many small banks throughout the country". In explaining the vault-cash provision of the Act, the Report of the Senate Committee on Banking and Currency stated:

"The counting of vault cash as reserves would correct a generally recognized inequity that now exists because many banks find it necessary for operating purposes to hold larger amounts of vault cash than do other banks. Since vault cash holdings and reserve balances at the Reserve banks are interchangeable and both serve the same purpose in influencing the volume of bank credit, they should both be counted as reserves. Counting of vault cash as reserves would also have collateral advantages, such as reducing the costs of transporting and handling currency and facilitating the holding by member banks of larger stocks of currency that would be available over widely dispersed areas for use in a national emergency."

With respect to the implementation of the vault-cash provision of the Act, the House Committee on Banking and Currency pointed out that:

"If all vault cash held by member banks were immediately counted as satisfying reserve requirements, approximately \$2 billion would be added at a single stroke to the available supply of bank reserves. To avoid the undesirable effects of such a sudden increase, the bill would give the Board authority to put this change into effect gradually, by permitting member banks to count 'all or part of their currency and coin

as reserves.' The Board would thus have discretion in timing, so as to make these changes when economic conditions are most suitable. The Board could, for example, start out by permitting banks to count all vault cash over 3 per cent of demand deposits; then all over 2 per cent, and so on until all vault cash is counted. This is given only as an example, of course; the Board would have wide discretion in determining the mechanics of how the change is put into effect."

Earlier, in testifying on the legislation before the Banking and Currency Committees of both the Senate and the House, the Vice Chairman of the Board had indicated that some action to offset releases of vault cash might be necessary. For example, during the hearings before the Senate Committee, he said that "It would... be necessary to put any such change into effect gradually, and perhaps to offset it in part by adjustments in the reserve requirement percentages."

The increase in the reserve requirement percentage for country banks was a partial offset to the very large amounts of reserves made available to those banks by the release of their vault cash for use as reserves. One of the original reasons for lower requirements for country banks than for reserve city banks was because country banks found it necessary to hold more cash in addition to their reserve balances than did the city banks. Permitting them to count their cash as reserves eliminated this basis for a differential in the requirement percentages.

In any event, as pointed out in the Board's official announcement, the differential between country bank and reserve city bank requirements against net demand deposits, under the revised regulation, amounting to 4.5 percentage points (16.5 minus 12), is greater than the previously existing differential between the totals of required reserves and average cash holdings for the two groups of banks (18.2 per cent minus 14.5 per cent, or 3.7 points).

Expressing the same comparison in terms of amount of reserves released, as a result of all actions taken in the past year, in accordance with the 1959 Act, the total amounts of reserve balances and vault cash that all country banks will be required to hold will be over \$1 billion less than would have been required under the regulation in force a year ago. This represents a reduction of nearly one-fifth from the total of vault cash and required reserves against demand deposits that would have been required under the previous regulation. The corresponding reduction for reserve city banks will have been about \$700 million, or one-tenth,

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and that for central reserve city banks \$550 million, about one-ninth. It is evident, therefore, that the position of country banks has been made more favorable, from their standpoint, relative to other banks, and that there has been no discrimination in favor of the large banks.

Adjustment in the reserve requirement percentage for central reserve city banks is essential at some time to comply with the provision of the 1959 law that has the effect of requiring that the differential between central reserve city and reserve city banks be eliminated by July 1962. The first adjustment was made as a part of the Board's action last August.

Since, of the three classes of banks, central reserve city banks not only have the highest requirements but also obtain the least benefit from the vault cash release, it is appropriate that the actions on all these fronts be taken at the same time. Moreover, the central reserve city banks have been under the greatest pressure because their deposits have increased less while their loan demand has been greater than was the case for the other classes of banks. The central reserve city banks also have probably suffered more from the loss of funds reflected in the gold outflow.

In view of their obvious interest in the matter, I am taking the liberty of sending copies of this correspondence to the Chairmen of the Senate and House Committees on Banking and Currency.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures (2)