Minutes for February 23, 1961

To: Members of the Board

From: Office of the Secretary

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

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

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

Chm. Martin
Gov. Szymczak
Gov. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson
Gov. King
Minutes of the Board of Governors of the Federal Reserve System on Thursday, February 23, 1961. 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. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Johnson, Director, Division of Personnel Administration
Mr. Harris, Coordinator, Office of Defense Planning
Mr. Masters, Associate Director, Division of Examinations
Mr. Smith, Assistant Director, Division of Examinations
Mr. Rudy, Special Assistant, Legal Division
Mr. Potter, Legal Assistant

Discount rates. The establishment without change by the Federal Reserve Banks of Boston and Atlanta on February 20, 1961, 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.

Items circulated to the Board. The following items, which had been circulated to the members of the Board and copies of which are attached to these minutes under the respective item numbers indicated, were approved unanimously:
Letter to Hightstown Trust Company, Hightstown, New Jersey, approving the establishment of a branch at the intersection of Routes 33 and 526, Robbinsville, Washington Township.

Letter to the Comptroller of the Currency recommending favorably with respect to an application to organize a national bank at Wausau, Wisconsin.

Letter to the Comptroller of the Currency recommending unfavorably with respect to an application to organize a national bank at Jacksonville, Florida.

Letters to Mr. John J. McCloy, New York, New York, and Mr. William A. Mitchell, President, The Central Trust Company, Cincinnati, Ohio, relating to the Advisory Committee on Commercial Bank Preparedness.

With respect to Item No. 3, Governor King commented that if branch banking was permitted in the State of Florida and this application had been for the establishment of a branch rather than the organization of a new bank, it seemed quite probable that the application would have been approved. Accordingly, although he concurred in the unfavorable recommendation to the Comptroller of the Currency, he was not sure whether a disapproval of the application would represent real justice in the eyes of the parties concerned.

Mr. Harris then withdrew and Mr. Thompson, Supervisory Review Examiner, Division of Examinations, entered the room.

Application of First Virginia Corporation. There had been distributed copies of two memoranda from the Division of Examinations, dated February 15 and 16, 1961, respectively, and a memorandum from the
Legal Division dated February 21, 1961, relating to the application of First Virginia Corporation, Arlington, Virginia, for approval of the acquisition of stock of the Falls Church Bank, Falls Church, Virginia. The Commissioner of Banking of Virginia had interposed no objection, and both the Richmond Reserve Bank and the Division of Examinations recommended approval.

At the request of the Board, Mr. Thompson reviewed the salient features of the application, his comments being based on the memoranda from the Division of Examinations.

Governor Mills expressed the view that two factors deserved close scrutiny. The first related to the nature of the contractual undertaking between First Virginia Corporation and the Falls Church Bank, which provided among other things for the continued employment of the two principal officers of the bank, their lifetime retention as consultants in the event of retirement or disability, and the payment of stipulated monthly amounts to their widows. Thus, although the other shareholders were being offered the same price for their shares as the two principal officers, the latter were receiving an extra consideration by virtue of the special arrangement, and it was not clear from the available information whether this arrangement had been made known to the other shareholders. Governor Mills indicated that he had grave reservations about such a transaction. However, he was not sure from a legal standpoint to what extent such a feature should be taken into account in passing upon an application under the Bank Holding Company Act.
Governor Mills also pointed out that First Virginia Corporation had outstanding two classes of stock, one of which carried voting rights and was held closely in the hands of the management. The other class of stock, which was the vehicle for introducing new capital into the organization, carried no voting rights. He commented that this practice was frowned upon by financial analysts. He thought it was regarded questionably by the Securities and Exchange Commission, and he understood the New York Stock Exchange had restrictions with regard to the listing of nonvoting stock.

In reply, Mr. Hackley pointed out that First Virginia Corporation had the same classes of stock outstanding when a previous application by that company was acted upon by the Board. On the earlier occasion, some consideration was given to this matter by the Legal Division, but the Division had not reconsidered the arrangement in connection with the current application. As to the first point mentioned by Governor Mills, it was his initial reaction that unless the arrangement with the two principal officers had some direct effect on the financial condition, management, or prospects of the applicant holding company or the bank involved, it might not be a relevant consideration.

Mr. Solomon commented in similar terms, expressing some doubt as to whether a feature of this kind was the sort of thing intended to be reached by the provisions of the Bank Holding Company Act. He noted there are many practices on the part of bank holding companies that the Act does not attempt to regulate.
After further discussion of the questions raised by Governor Mills, reference was made to the comments in the staff memoranda relating to the other holding company operating in the same area as First Virginia Corporation. Due to an exemption in the Bank Holding Company Act, that company was not subject to the provisions of the Act. The applicant indicated that the other holding company also had made overtures to the Falls Church Bank and in that connection had made statements to the effect that it might take some period of time for First Virginia Corporation to obtain approval of an application from the Board of Governors. First Virginia had indicated in submitting its application that it would like to be in a position to consummate the proposed acquisition of shares of the Falls Church Bank by the end of February.

Upon request, Mr. Hackley then summarized the point of view expressed in the Legal Division's memorandum, indicating that in this case there appeared to be some evidence of benefits flowing from the proposed transaction which would more than offset the relatively slight amount of competition that would be eliminated. It was the view of the Legal Division that approval by the Board would not be considered arbitrary or unreasonable upon judicial review.

Governor King stated that he had not had an opportunity to review the matter fully, and in the circumstances consideration was given to whether action on the application should be deferred. However, in response to a suggestion by Governor Mills, Governor King indicated that he would
be agreeable to abstaining from participation in the decision. Accordingly, it was agreed to proceed on that basis.

Governor Mills stated that he would favor approval of the application, but with reservations because he felt that this would represent countenancing a transaction (that is, the agreement between First Virginia Corporation and the principal officers of the bank involved) that was of questionable propriety. If approval were given, it would be with the knowledge that the Board had approved a transaction concerning which it appeared that there had not been full disclosure.

Governor Robertson stated that he had reservations similar to those expressed by Governor Mills. However, in previous cases under the Bank Holding Company Act the Board had not considered factors of this kind, and he questioned whether they should enter into the decision in this case. Looking to the future, he suggested that a study be made by the Legal Division and the Division of Examinations concerning both of the problems mentioned by Governor Mills in order that the Board might determine whether it should give consideration to such matters. If the Board then made an affirmative determination, he felt that all bank holding companies should be put on notice.

Governors Shepardson, Szymczak, and Balderston and Chairman Martin indicated that they would favor approval of the application. In addition, they would favor a study such as outlined by Governor Robertson.
Accordingly, the application of First Virginia Corporation was approved, Governor King abstaining, and the staff was requested to draft for the Board's consideration an order and supporting statement that would carry out this decision. It was understood that the Legal Division and the Division of Examinations would undertake a study along the lines suggested by Governor Robertson.

Mr. Fauver, Assistant to the Board, entered the room during the foregoing discussion. At its conclusion Messrs. Rudy, Thompson, and Potter withdrew and Mr. Connell, Controller, entered the room.

Changes in examining procedures (Item No. 6). There had been distributed copies of a memorandum from the Division of Examinations dated February 2, 1961, outlining new methods and techniques proposed to be developed for use by the Board's field examining staff in conducting examinations of Federal Reserve Banks. A copy of the memorandum is attached as Item No. 6.

At the Board's request, Mr. Solomon discussed in some detail the nature and background of the proposed examining procedures and contrasted the approach embodied therein to the procedures currently followed by the Board's examining staff. He also spoke of certain indications by other persons to whom he had spoken recently, including an official of the Treasury Department, which revealed a favorable attitude toward the concept of auditing reflected in the suggested procedures.
Mr. Solomon commented that the Division of Examinations had considered it desirable to present the matter to the Board at this stage in order to obtain an expression of the Board's views before proceeding with the work that would be required before any procedures along the lines suggested could be introduced on a trial basis. In this connection, he brought out that a meeting of the Conference of General Auditors of the Federal Reserve Banks was scheduled for the latter part of April and that, if the Board's reaction to the revised procedures was favorable, it would seem advisable to discuss the subject at that time.

Governor Robertson expressed the view that the memorandum of the Division of Examinations presented a desirable program, one that should have been put into effect before this time.

Governor Mills said that he did not pretend to have a full grasp of the mechanics of the approach recommended by the Division of Examinations. However, the spirit of the Price Waterhouse recommendations was that there should be a change in direction of the examinations of the Federal Reserve Banks, with more reliance placed on verification procedures followed by the Auditing Departments of the respective Banks to avoid a duplication of functions, and this had always made sense to him. As he understood the recommendations, it was intended that there would be spot analyses, in depth, of the functioning of the various departments of the Federal Reserve Banks, and this also made sense to him. Of course, there would have to be constant observation of the new procedures by the Federal Reserve Banks, the Board, and the Division of Examinations. At this point, however, the only question he would raise had to do with whether
the field examining staff was likely to become involved in what might be called "experting" the work of the several departments of the Reserve Banks. This was a function of the Division of Bank Operations, and he felt it important that lines of demarcation be worked out carefully.

Mr. Solomon commented that the point raised by Governor Mills had been considered by the Division of Examinations and discussed with the Division of Bank Operations. It was recognized that there should be no blurring of the lines of responsibility. However, the Division of Examinations would be pleased if its work should prove to be of assistance to the Division of Bank Operations.

Governor Robertson commented on the type of personnel that would be required to operate effectively along the lines envisaged by the proposed procedures. It was possible, he pointed out, that the need for top-flight personnel might increase the cost of the examining function. Although the current proposal did not provide for regionalizing the examining force in the manner that had been suggested by Price Waterhouse, it was his opinion that this development would take place eventually. Among other things, individuals of the caliber needed to conduct the proposed type of examination might be difficult to obtain if extensive travel over the country as a whole was required.

Mr. Farrell commented with respect to the consideration given to the proposed approach from the standpoint of the work of the Division of Bank Operations and expressed the opinion that a satisfactory division of
responsibilities could be worked out along lines that would work to the mutual benefit of all concerned.

Governor Shepardson expressed the view that the recommended approach was definitely worthwhile, and expressions by Governors King and Szymczak were favorable.

Governor Balderston said that as a general observation he was in favor of the recommendations. If the new procedures were put into effect, he hoped that some surprise verifications would be retained in the program, and he understood that this was envisaged. Governor Balderston also suggested that pressure be continued to cause the directors of the Federal Reserve Banks to keep the auditing staffs of the Banks from being influenced unduly by the operating officers. He noted that there were still some Banks where it was felt that operating officers should be present at meetings at which the General Auditor reported to the Auditing Committee of the Board of Directors, and to him such a procedure was indefensible. Beyond that, moreover, there was the instinctive desire of the auditors to advance themselves within the Reserve Bank organization, in which connection an opinion might exist that the manner in which they were evaluated by the operating management of the Bank was an important factor.

The discussion concluded with a statement by Chairman Martin to the effect that the Division of Examinations was authorized to take steps to implement the recommendations contained in the memorandum of February 2, 1961.
Messrs. Fauver, Farrell, Connell, and Smith then withdrew.

Policy concerned with granting trust powers to national banks.

There had been prepared and distributed, pursuant to an earlier request of the Board, a memorandum from Mr. Masters dated February 6, 1961, reviewing the policy and underlying considerations concerned with the authority of the Board to grant to national banks the right to act in fiduciary capacities. The memorandum reviewed the background of law and regulation, the basis and application of the criteria set forth in section 2 of Regulation F, Trust Powers of National Banks, and other considerations related to the policy question. These considerations included the effect of bank supervision and examination. Other sections of the memorandum dealt with the questions involved in the "part-time" trust operation and in applications of small banks for trust authority, and a final section and appendices related to the denial of trust power applications.

The tenor of the conclusions in the memorandum was that the considerations recited in section 2 of Regulation F must be applied collectively, as an over-all subjective test, to all of the facts and circumstances presented by a particular application. It was suggested that primary attention to, and emphasis on, the condition of the applicant bank, the adequacy of its capital, and the character and ability of its management would most reasonably assure the result sought by the statute; namely, the proper exercise of the trust powers granted. The memorandum also pointed out that confidence in the safe and sound exercise of the
trust authority must rely heavily on the effectiveness of the bank supervisory function, for there could otherwise be no assurance that favorable conditions existing at the time an application was granted would continue in the future. It was noted that an evaluation approach based on careful appraisal of bank management and bank condition had characterized staff practice for many years, and the view was expressed that this would be the wisest course to follow in the future.

At the Board's request, Mr. Masters presented a summary statement on the subject, his comments being based on the memorandum that had been distributed.

Governor Mills said that he had no question. He felt that the information presented in the memorandum and Mr. Masters' discussion thereof represented an admirable review course, and that present practices were adequate.

Governor Robertson expressed a similar view. He then raised the question whether the Board's letter to the Federal Reserve Banks dated March 14, 1957, regarding the processing of applications for trust powers appeared to require review or supplementation, and also whether it would appear desirable to send copies of Mr. Masters' memorandum to the Reserve Banks for their information.

Mr. Masters replied that the letter to the Reserve Banks was of relatively recent date, the Reserve Banks were known to have the subject matter of that letter closely in mind in processing applications, and the
current memorandum did not suggest any substantial change in the principles set forth in the 1957 letter. He saw no objection to sending copies of the memorandum to the Reserve Banks if the Board was so inclined.

After Governors Shepardson, King, and Szymczak had indicated that they were satisfied with the presentation contained in the memorandum, Governor Balderston commented to the effect that although the qualifications of a bank applying for trust powers might be appraised carefully in reaching a decision, there was no guarantee that satisfactory conditions revealed at the time of the application would continue to prevail, and there was no power to terminate the trust authority after it had been granted. This emphasized the reliance that must be placed on bank supervision through the Office of the Comptroller of the Currency, which led him to raise the question whether it would be advisable to send copies of Mr. Masters' memorandum to the Comptroller for distribution within that organization.

It was pointed out, in discussion of this point, that the functions of the Comptroller do not relate to the granting of trust powers. Also, there was no indication that the supervision afforded by the Comptroller's Office was not careful or competent. In the circumstances, it was the consensus that the memorandum need not be sent to the Comptroller.

At the conclusion of the discussion, it was understood that the principles set forth in the memorandum from Mr. Masters were acceptable to the Board as guides in considering applications from national banks for authority to exercise trust powers. It was also understood that
copies of the memorandum would be sent to the Federal Reserve Banks for their information.

Messrs. Hackley, Solomon, and Masters then withdrew.

Pre-employment investigations. There had been circulated to the Board a memorandum from the Division of Personnel Administration dated February 7, 1961, recommending that, as a permanent policy, a pre-employment full field security investigation be made of all applicants from outside the Board's organization selected to fill sensitive positions above Grade FR-5, with the understanding that, should it appear that an outstanding applicant would be lost if his employment were deferred until the completion of the investigation, the requirement could be waived upon concurrence of the member of the Board having responsibility for internal affairs of a managerial nature.

The memorandum noted on April 17, 1958, the Board approved for a trial period of one year a procedure under which pre-employment full field investigations were to be made of applicants selected to fill sensitive positions above Grade FR-5. The procedure was continued for an additional year in 1959 and again in 1960, but it was now felt that experience warranted a recommendation for a permanent policy.

In response to a question by Governor Robertson, Mr. Johnson verified that the procedure in effect since 1958 had not in any instance prevented the Board from obtaining the services of a desirable applicant.
Governor Robertson commented that it was his understanding that the recommended procedure would not be permitted to result in the loss of a qualified addition to the Board's staff, and there was no indication to the contrary. Mr. Johnson pointed out that access to classified material would not be authorized after employment until receipt of the investigation report and issuance of the prescribed authorization.

The recommendation contained in the memorandum was then approved unanimously.

Appointments at Federal Reserve Bank of Minneapolis (Item No. 7). In a letter dated February 14, 1961, Chairman Bean of the Federal Reserve Bank of Minneapolis advised that the Bank's directors had appointed Frederick L. Deming as President and A. W. Mills as First Vice President, each for a term of five years beginning March 1, 1961, subject to the approval of the Board of Governors, with salary at the rates of $35,000 and $25,000 per annum, respectively, for the period March 1, 1961, through December 31, 1961. Mr. Bean enclosed a letter from Mr. Mills dated February 13, 1961, which indicated that the latter intended to retire from active service with the Reserve Bank on November 30, 1964, the end of the first month after he reached age 65. There had been circulated to the Board a draft of letter to Chairman Bean indicating approval of the appointments and salary rates.

No objection being indicated, the proposed letter to Chairman Bean was approved unanimously. A copy is attached as Item No. 7.

The meeting then adjourned.
Secretary's Notes: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Balderston, acting in the absence of Governor Shepardson, approved on behalf of the Board on February 17, 1961, increases in the basic annual salaries of the following persons on the Board's staff, effective February 19, 1961:

<table>
<thead>
<tr>
<th>Name and title</th>
<th>Division</th>
<th>Basic annual salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margaret V. Hastings, Economist</td>
<td>Research and Statistics</td>
<td>$5,850 to $6,435</td>
</tr>
<tr>
<td>George G. Noory, Analyst</td>
<td>Bank Operations</td>
<td>5,685 to 5,850</td>
</tr>
<tr>
<td>Ellen C. Cunningham, Statistical Clerk</td>
<td>Bank Operations</td>
<td>4,145 to 4,250</td>
</tr>
<tr>
<td>Thomas L. Hunter, Jr., Supervisory Review Examiner</td>
<td>Examinations</td>
<td>12,990 to 13,250</td>
</tr>
<tr>
<td>Mary E. Sanders, General Assistant</td>
<td>Administrative Services</td>
<td>6,545 to 6,710</td>
</tr>
<tr>
<td>Myrtle M. Evans, Cafeteria Helper</td>
<td></td>
<td>3,290 to 3,395</td>
</tr>
<tr>
<td>Elsie E. Anderson, Charwoman</td>
<td></td>
<td>3,185 to 3,290</td>
</tr>
<tr>
<td>Florence S. Doane, Clerk (Librarian)</td>
<td>Personnel Administration</td>
<td>2,038 to 2,090</td>
</tr>
</tbody>
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Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson approved on behalf of the Board on February 21 and 23, 1961, respectively, the following items relating to the Board's staff:
2/23/61

Salary increase

Richard S. Landry, Assistant to the Secretary, Office of the Secretary, from $8,080 to $8,340 per annum, effective March 5, 1961.

Appointment

Carolyn M. Hall as Statistical Clerk, Division of Research and Statistics, with basic annual salary at the rate of $3,865, effective the date of entrance upon duty.
Board of Governors, of The
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D.C.

February 23, 1961

Pursuant to your request submitted through the Federal Reserve Bank of Philadelphia, the Board of Governors of the Federal Reserve System approves the establishment of a branch at the intersection of Routes 33 and 526, Robbinsville, Washington Township, Mercer County, New Jersey, by Hightstown Trust Company, Hightstown, New Jersey. This approval is given provided the branch is established within one year from the date of this letter. It is noted that the capital stock will be increased to $200,000 to comply with New Jersey statutory requirement.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
February 23, 1961

Comptroller of the Currency,
Treasury Department,
Washington 25, D. C.

Attention Mr. W. M. Taylor,
Deputy Comptroller of the Currency.

Dear Mr. Comptroller:

Reference is made to a letter received from your office dated December 8, 1960, enclosing copies of an application to organize a national bank at Wausau, Wisconsin, and requesting a recommendation as to whether or not the application should be approved.

The report of investigation of the application made by an examiner for the Federal Reserve Bank of Chicago indicates that the organizers have agreed to provide a minimum capital structure for the bank of $400,000 instead of $250,000 shown in the application. This capital structure appears to be adequate. The report discloses generally favorable findings with respect to the prospects for profitable operations, the proposed management, and the need for additional banking facilities in the area. Accordingly, the Board of Governors recommends favorable consideration of the application.

The Board’s Division of Examinations will be glad to discuss any aspects of this case with representatives of your office if you so desire.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
February 23, 1961

Comptroller of the Currency,
Treasury Department,
Washington 25, D. C.

Attention Mr. W. M. Taylor,
Deputy Comptroller of the Currency.

Dear Mr. Comptroller:

Reference is made to a letter from your office dated October 6, 1960, enclosing copies of an application to organize a national bank at Jacksonville, Florida, and requesting a recommendation as to whether or not the application should be approved.

Information contained in a report of investigation of the application made by an examiner for the Federal Reserve Bank of Atlanta indicates that the proponents plan to provide a capital structure of $1,250,000 for the proposed bank and that $1,000,000 may be invested in the purchase of the present banking quarters of the Florida National Bank of Jacksonville. In the event the proposed large investment in fixed assets is made the indicated capital structure would not appear to be adequate. However, it was stated that the organizers would be agreeable to increasing the capital structure to an amount acceptable to the supervisory authorities. The prospects for future earnings of the proposed bank and the arrangements for management appear satisfactory. The proposed bank, which would be a part of the Florida National Group of banks, would be located within two blocks of the new location of the Florida National Bank of Jacksonville and may result in an unfair competitive advantage over other banks in the immediate area. Moreover, there does not appear to be a basic need for the continuation of a bank at the proposed location, and it seems improbable that the lack of such banking services there will materially inconvenience any substantial number of individuals or firms. Accordingly, the Board of Governors recommends disapproval of the application.

The Board's Division of Examinations will be glad to discuss any aspects of this case with representatives of your office if you so desire.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
Mr. John J. McCloy,
C/o Milbank, Tweed, Hope
& Hadley,
15 Broad Street,

Dear Jack:

The Board has regretfully acceded to your request to be relieved from the Advisory Committee on Commercial Bank Preparedness. The reasons prompting your request are fully understood.

When the Committee was established, it had two major objectives: first, to provide commercial banks with practical guidance on defense preparedness, and second, to promote effective action on the guidance given. The first objective has been accomplished. While the second objective is a continuing one and much remains to be done, the Board has noted that approximately 67 per cent of commercial banks with deposits of $100 million or more now have preparedness programs, and that participation among all banks increased 12 per cent during the last six months' reporting period. Of special significance is the fact that this has been accomplished on a purely voluntary basis.

Please accept the Board's appreciation for the contributions which you as Chairman and the members of your Committee have made in encouraging defense preparedness among commercial banks.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Mr. William A. Mitchell, President,
The Central Trust Company,
Cincinnati 1, Ohio.

Dear Bill:

Mr. McCloy has asked to be relieved as Chairman of the Advisory Committee on Commercial Bank Preparedness due to his retirement from an active banking position and his new assignment with the Government. The Board has regretfully acceded to his request and expressed its appreciation for the contribution made by Mr. McCloy as Chairman and by other members of the Committee.

You will recall when the Advisory Committee was established it had two major objectives. It has accomplished one of its objectives by providing guidance to commercial banks and has made considerable progress on the other objective— that of promoting effective action by banks. It would seem that this Committee should be continued— at least until a special effort has been made to get as nearly as possible 100 per cent participation by banks having $100 million or more deposits. There are less than 300 banks in this category and I am informed that approximately 67 per cent of them have a defense program. I feel that the Committee can be most helpful by encouraging the remaining 33 per cent to participate, and that the results will serve as an inspiration to the various banking organizations and supervisory authorities in their continued maintenance of the program.

It would be appreciated if you would be willing to serve as Chairman of the Advisory Committee for the limited task above described. No doubt you would like to have representation on the Committee from the New York area. Your suggestion as to a prominent New York banker who might be invited to serve on the Committee would be welcome.

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.
To: Board of Governors

From: Division of Examinations

February 2, 1961

Subject: Possible Changes in Procedures for Examining Federal Reserve Banks.

CONFIDENTIAL (F.R.)

The purpose of this memorandum is to outline, for consideration by the Board, proposed new methods and techniques to be developed for use by the Board's field staff in conducting examinations of Federal Reserve Banks.

It may be recalled that in reporting the results of its 1958 survey of the procedures applied by the field examining staff, Price Waterhouse & Co. expressed the opinion that such procedures represent too great a duplication of the work of the Reserve Banks' internal auditing staffs, and fail to give sufficient weight to the internal auditing function and to the Reserve Banks' internal controls. The report suggested that the more routine audit procedures be curtailed and that greater emphasis be given to surveys of the operations and procedures of the Reserve Banks and their auditing departments.

This examination concept closely parallels one outlined by E. A. Wayne, Acting Director, Division of Examinations, in his memorandum to the Board dated April 6, 1951, and provisionally approved by the Board on May 3, 1951. It also accords with what appears to be a growing trend of thought in the accounting profession.

Following their 1959 engagement, Price Waterhouse & Co.'s report dealt for the most part with their analysis of specific procedures and techniques incorporated in the examination program, but at the same time made it clear that they continued to hold the opinion that some basic changes in the examination approach could profitably be made. We have not as yet received their report following a survey conducted in the latter part of 1960, but it may be fairly assumed that, either expressly or impliedly, this report will reflect a similar view.

Although the Division of Examinations regarded some aspects of the more wide-ranging suggestions made in the 1958 report of Price Waterhouse & Co. (e.g., the regional decentralization of the examining staff) as impracticable, untimely, or undesirable for various reasons, we are, upon reflection, impressed with the possibilities presented by the survey type of examination that seems to be fundamental in the thinking outlined above. Accordingly, if the Board does not object, we will proceed with the development of an examination program incorporating this different concept, with a view of putting it into effect -- at least on a trial basis -- about mid-year. It is thought that necessary preliminary studies will have been completed by then so that at least a trial application of the new procedures may be made in an orderly manner and with sound reason for expecting a successful result.
Present Question

Even after a trial application of the proposed new procedures, we would propose to check back with the Board before permanently shifting over to the new approach. The present question, therefore, is whether the Board would object to having the Division of Examinations develop the proposed new procedures and apply them in one or more "test runs."

Proposed examination approach

Briefly stated, the examination we have in mind would be a review of methods and procedures supplemented by whatever test verifications may seem indicated. This would mean that the present rather detailed audit verifications would in many instances be drastically curtailed or entirely omitted.

It is contemplated that the review examination would embrace some or all of the following procedures:

1. A study of the Reserve Banks' policies and procedures as prescribed for a particular operation or function.

2. A determination that there are incorporated in the operating procedures, to the extent practicable, checks and balances that would promptly bring to light in the course of the normal work flow any errors or omissions, either accidental or deliberate.

3. A determination, by observation of the operations, that the prescribed policies and procedures are being followed.

4. A test examination of the recordation of transactions both before and after the commencement of the examination.

5. Test verifications of account balances to the extent and in the manner deemed necessary for the accomplishment of the intended objectives. (The selection of the areas to be tested and the nature and extent of the tests applied would be tailored to fit the situation revealed by the examiners' study of the safeguards built into the operating procedures and other internal control provisions designed to assure the integrity of the operations.)
6. A continuation of the present practice of making a detailed and intensive study of the coverage provided by the internal audit function. However, this might be broken into segments, each examiner in charge of an assignment being responsible for analyzing the audit attention given the function under his review, with special reference to any shortcomings revealed by the periodic audits and the remedial measures taken.

   a. The present practice of observing auditing departments while engaged in the performance of their audit duties would be continued, and probably extended, with the objective of bringing about a further strengthening and improvement of the audit procedures whenever appropriate.

Through these methods, the examiners will be probing the affairs of the Bank in depth, and the results of their verifications should provide satisfactory assurances that the affairs of the Reserve Banks are being properly conducted and that the books of account accurately reflect the assets and liabilities on a day-to-day basis. If properly done, it is believed that these examination procedures will provide a more thorough knowledge and a sounder appraisal of a Reserve Bank's activities than results from the program now in effect.

It is contemplated that complete flexibility and freedom of action will be reserved to the Chief Federal Reserve Examiner. By this is meant that he will not be committed to a specific routine for any given function; in fact, if it seems warranted, he may carry out a complete verification of the accounts and holdings in a given department, or he may on occasion revert to our present verification type of examination for the whole Bank. Because of this flexibility, the Reserve Bank's personnel will be unable to anticipate what procedures will be used or what direction the examination will take, and to that extent the examination should have more effective results.

Possible Effects on Costs and Personnel

The main objective of the proposed changes would be further strengthening and improvement of the examinations of the Reserve Banks. Any effects on costs or personnel would be merely incidental to that main objective.

Nevertheless, the new procedures might in time result in some reduction in total manpower needs -- probably first in the area of borrowed help, and perhaps later in the number of men employed on the
To: Board of Governors

field force for relatively routine duties. However, since rather complete audits of some individual functions might continue to be made selectively from time to time in order to insure variation and surprise, any reduction in the field force probably would occur gradually rather than abruptly. Over the long run, the new approach probably would require more men of relative high calibre, and this might even result in an increase in total salary costs.

Relation to Work of Division of Bank Operations

It is not believed that the proposed program will result in any overlapping of the field work of the Division of Bank Operations. This is because the investigations of the examiners will be pursued mainly with the objective of determining the measures taken to safeguard the assets and assure the integrity of the operations, whereas the interests of the Bank Operations' representatives are primarily in the areas of costs and operational efficiency.

Relation to Internal Audit Programs

If procedures of the kind described are adopted and put into effect, it may be appropriate for the Reserve Banks' General Auditors to revise the minimum frequencies of audits heretofore established by the Conference of General Auditors. If the Board has no objection, we would have the matter placed on the agenda of the Conference of General Auditors to be held on April 26-28, 1961, to provide opportunity for a full discussion of the effect that the reduction of emphasis on audit verifications in the Board's examining procedures may have on the internal audit programs.

Conclusion

Although, as stated previously, the Board was in general agreement with a similar examination approach when proposed by Mr. Wayne in 1951, the examination procedures were not thereafter markedly revised. Moreover, it is believed that the present proposal goes further than Mr. Wayne contemplated in the curtailment of the verification procedures that have been traditionally followed by the Board's examiners. It is recognized, also, that there may be reasons which would cause the Board to feel that it might be unwise to make a major change at this time in the kind of examination conducted by the Board's staff.

It will be helpful, therefore, to have an expression from the Board on the subject before a great deal of time is consumed on the preparatory studies that will be entailed.
CONFIDENTIAL (FR)

Mr. Atherton Bean,
Chairman of the Board,
Federal Reserve Bank of Minneapolis,
Minneapolis 2, Minnesota.

Dear Mr. Bean:

The Board of Governors has approved the appointment of Mr. Frederick L. Deming as President and Mr. A. W. Mills as First Vice President of the Federal Reserve Bank of Minneapolis, each for a term of five years beginning March 1, 1961, in accordance with the action taken by the Board of Directors as reported in your letter of February 14, 1961.

The Board of Governors has also approved the payment of salaries to Messrs. Deming and Mills at the rates of $35,000 and $25,000 per annum, respectively, for the period March 1, 1961, through December 31, 1961.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.