Minutes for March 27, 1962

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. 1/

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. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson
Gov. King
Gov. Mitchell

1/ Meeting with Presidents of the Federal Reserve Banks.

A joint meeting of the Board of Governors of the Federal Reserve System and the Presidents of the Federal Reserve Banks was held in the Board Room of the Federal Reserve Building in Washington, D. C., on Tuesday, March 27, 1962, at 3:25 p.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Mitchell

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel

Messrs. Ellis, Bopp, Wayne, Bryan, Scanlon, Clay, Irons, and Swan, Presidents of the Federal Reserve Banks of Boston, Philadelphia, Richmond, Atlanta, Chicago, Kansas City, Dallas, and San Francisco, respectively

Messrs. Treiber and Francis, First Vice Presidents of the Federal Reserve Banks of New York and St. Louis, respectively

Mr. McConnell, Vice President, Federal Reserve Bank of Minneapolis

The Presidents of the Federal Reserve Banks were in receipt of a letter from the Board of Governors dated March 21, 1962, which referred to the Board's concern of long standing regarding the difficulties involved in enforcing the position that absorption of exchange charges by member banks involves an indirect payment of interest on demand deposits. The letter also noted the inequities of a situation under which member banks and nonmember insured banks were subject to different rules under similar provisions of law. It was pointed out that studies in recent months of the possibility of devising an acceptable administrative rule in applying the law and further discussions of the matter with the Federal Deposit

Insurance Corporation and the Comptroller of the Currency had afforded no clearly satisfactory basis for a solution to the problem. In the circumstances, the Board was now giving serious consideration to the desirability of amending Regulation Q, Payment of Interest on Deposits, to provide that the absorption of normal and customary exchange charges by member banks in connection with the routine collection for their depositors of checks drawn on other banks would not be considered a payment of interest on deposits. This would be consistent with the position taken by the Federal Deposit Insurance Corporation with respect to nonmember insured banks. The letter indicated that the Board would like to have the benefit of a discussion of this problem with the Presidents of the Federal Reserve Banks and that discussion with the Federal Advisory Council also was contemplated. Enclosed with the letter was a memorandum summarizing the background of the matter and setting forth arguments that might be advanced for and against a reversal of the Board's position that absorption of exchange by member banks constitutes a payment of interest.

After making introductory comments, Chairman Martin invited an expression of views around the table by the Reserve Bank representatives present.

Mr. Treiber commented that this had been a knotty problem. He noted that there were no nonpar banks in the Second Reserve District, so the New York Reserve Bank's only immediate contact was with the problem of absorption of exchange. The Reserve Bank, he said, would see no objection to permitting the absorption of customary exchange charges by

member banks in connection with the collection of checks, unless it was felt that this would stimulate nonpar activity or reduce the restraint on such activity. He did not feel that the New York Bank was close enough to the question to have a judgment on that point. The Reserve Bank was interested, however, in avoiding the type of problem that developed in the fall of 1960 when the Board took the position, for a period of about two months, that absorption of exchange constituted a payment of interest on demand deposits even when the amounts absorbed by a member bank were less than the cost of collecting them from depositors. That ruling had resulted in numerous questions involving the mechanics of charging back trivial amounts.

President Ellis indicated that his point of view was similar to that expressed by Mr. Treiber. If one could be sure that a reversal of the Board's position would not stimulate nonpar banking, he would urge such action. From the standpoint of relationships between member and nonmember banks, the prohibition of exchange absorption by member banks was one of the costs of membership that he would like to see abandoned.

President Irons noted that there was a sizable amount of exchange absorption in the Eleventh District; the District had been one of the problem centers from time to time. He was convinced that the present ruling of the Board, which authorized member banks to absorb exchange charges only in amounts aggregating not more than $2 for any one depositor in any one month, could not be enforced, and this opinion applied also to almost any other restrictive ruling that might be devised with respect to the problem. The Reserve Bank's examiners did not come in contact

with the large national banks in the District that were most active in exchange absorption, and he did not feel that the national bank examiners would go into the matter in sufficient detail to assure adequate enforcement. On occasions in the past, such as in the summer of 1960, when the matter was discussed with member banks, they had reacted unfavorably to the idea of a reversal of the position that absorption of exchange charges involves an indirect payment of interest on demand deposits. It appeared that the banks would like to have a restrictive rule in effect, but one not too severe. Personally, he would be agreeable to a reversal of the Board's position, as he was not sure any satisfactory alternative was available. However, he felt that there might be some question from the standpoint of timing. At the moment, District banks were expressing considerable dissatisfaction about the expense involved in paying the higher rates of interest on time and savings deposits that are permissible under the amendment to Regulation Q that became effective January 1, 1962. If the Board were now to reverse its position on the absorption of exchange, the banks would complain of a further increase of costs because of the necessity to compete fully in the absorption of exchange charges. Leaving aside the timing factor, however, he would be agreeable to the proposal.

President Swan indicated that his position was much the same as that expressed by Messrs. Treiber and Ellis. There was no real problem in the Twelfth District because of the virtual absence of nonpar banking, and in his opinion District banks probably would welcome the proposed change in the Board's position. Basically, he felt that the Board would

be in a much more realistic position if this change were made. Opposition to nonpar banking should be expressed by the Federal Reserve in a more fundamental way; that problem ought to be met in terms of seeking remedial legislation.

President Scanlon expressed the view that some of the larger member banks in the Seventh District would hate to see the Board reverse its position. Further, if the Board should so decide, it must be prepared to accept some criticism growing out of the recent survey of nonpar banking that was made through the Federal Reserve Banks. In the Seventh District, at least, the banks that participated in the survey had spent considerable time and money in the process of obtaining information and making recommendations, and a reversal of the Board's position would go counter to the recommendations of the participant banks. Nevertheless, he did not think that the present position of the Board was enforceable, and he would favor its reversal.

President Clay expressed the view that from the standpoint of the banking system and the Federal Reserve System a reversal of the Board's position would constitute a significant step backward. There was no doubt in his mind as to the correctness of the Board's interpretation of the law, which held that the absorption by a member bank of exchange charges on checks collected for demand depositors would result in an indirect payment of interest on demand deposits. With the use of checks continuing

to grow and convenience accounts becoming more and more a matter of everyday life, he would hate to see a step taken that would encourage nonpar banking. At a time when banks were reaching for earnings to offset the cost of paying higher interest rates on time and savings deposits, he felt that a reversal of the Board's position might cause par banks to move in the direction of nonpar clearance or encourage nonpar banks to increase their exchange charges. As Mr. Irons had indicated, the reserve city banks wanted some kind of a moderately restrictive rule. He (Mr. Clay) was not prepared to say just how enforceable such a rule would be, but in the Tenth District, at least, there had been over the years some reduction of the number of nonpar banks, due largely to the efforts of credit associations, and such efforts might be abandoned if the Board reversed its position. On the other hand, there could be further progress if the Board continued to follow what he considered a correct principle. As to the competitive situation between member and nonmember banks, it was his feeling that reversal of the Board's position might put member banks in a worse competitive position and encourage them to move into nonpar banking. He was not disposed to think that the action now under consideration would lead to any quick steps toward the abolition of nonpar banking.

President Wayne commented that if the Board should reverse its position member banks in the Fifth District would be faced with a rather substantial dollar amount of exchange absorption. In his opinion they would absorb exchange. On the basis of current volume, he estimated that

such absorption would cost the largest bank in North Carolina about $60,000 a month, and the second largest bank in that State about $50,000-$60,000. For the largest bank in South Carolina the figure might run around $25,000, and the aggregate figure for the four principal correspondent banks in Richmond might be somewhere around $60,000 a month. This would not wreck the banks. However, he had seen in the past twenty years a progressive diminution of the number of nonpar banks, and he felt that without any doubt a reversal of the Board's position would lead to a spread of nonpar banking, not only on the part of smaller banks but on the part of larger banks made up of a system of small branches.

President Wayne said he remembered well the competitive actions of bankers of another generation that had resulted primarily from paying interest on demand deposits. He was not confident that bankers of the present generation would be more able to restrain themselves. In his view a restriction on the payment of interest on demand deposits was essential to the preservation of a sound banking system in this country. Therefore, he agreed with Mr. Clay that a reversal of the Board's position would be a backward move. He believed that the Board's interpretation of the law was legally correct, and he was not prepared to say that such an interpretation was unenforceable if the Board could see its way clear to go along with some of the proposals resulting from the recent survey that contemplated permitting the absorption of exchange in minor amounts. If that were done, he felt that a ruling against absorption of exchange on larger items would be largely self-enforcing. As to national banks,

the examiners had not been too active in enforcement in the past. Even if their enforcement procedures should not be vigorous, he felt that a reasonable ruling on the part of the Board would be observed by most banks.

President Bopp indicated that he would favor the action now under consideration. If the barrier against payment of interest on demand deposits was impregnable, except for the absorption of exchange, he might feel differently. However, many free services were being offered as compensation for the use of deposits, and these practices were likely to grow with the increasing use of computers. Such being the case, he would not feel strongly about a reversal of the Board's position on the absorption of exchange. Some correspondent banks, of course, would like to have a restriction maintained on the absorption of exchange charges, and their reaction was likely to be adverse.

President Bryan agreed with the view that a reversal of the Board's position would be a step backward. Nevertheless, he did not quite see how such an action could be avoided. He had been thoroughly in favor of maintaining a restrictive ruling against the absorption of exchange, and even strengthening it, so long as the Comptroller of the Currency was not actively opposed to such a position. However, with the Comptroller now indicating that he favored the position of the Federal Deposit Insurance Corporation, the Federal Reserve would be left in the position of endeavoring to enforce its position in terms of State member banks only or of ignoring the enforcement problem, and he did not believe either

position was tenable. If the current ruling was liberalized along lines suggested in the recent survey, some large banks nevertheless would want to go beyond the latitude of the ruling. In all the circumstances, he would conclude, although reluctantly, that in the present situation the Board's position ought to be reversed or substantially modified.

Mr. Francis commented that the rulings against absorption of exchange had not been very well enforced. There were some reasons to believe that such a position was not particularly enforceable. If the Board's position should be reversed, he felt confident that there would be substantial protests from member banks in the Eighth District, particularly in cities such as Little Rock and Memphis. As to the matter of timing, he was inclined to think that this might be a good time to take the contemplated action, because bankers presumably would not be anxious to assume the additional cost of absorbing exchange charges in view of the current cost pressures incident to the payment of higher interest rates on time and savings deposits. On balance, although he did not like the business of exchange absorption and nonpar banking and although he anticipated considerable criticism, it was his opinion that this was probably as good a time as any to make the contemplated change. In the long run, he felt that it would be for the best.

Mr. McConnell said that he had not had an opportunity to talk with President Deming and did not know what the latter's thinking might be. In the Ninth District, he did not believe that there were any violations of consequence. The principal correspondent banks in the

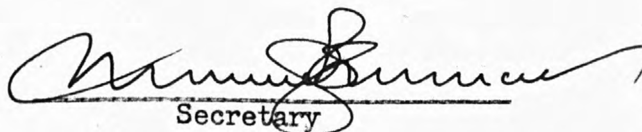
District were not absorbing exchange; in the recent survey their statements had been to the effect that they could not afford even to absorb the full amount permissible under the current Board ruling. He could not say for certain what their reaction would be to an amendment to Regulation Q of the kind now under consideration, but he guessed the reaction would be adverse. They liked to be in a position to say that they could not absorb exchange because it was contrary to a Federal Reserve ruling.

Governor Mills expressed agreement with the view that a reversal of the Board's position would be a serious step backward. He felt sure the member banks would believe that the Federal Reserve System had followed this course as a means of washing its hands of a problem with which it did not want to deal. Further, he felt that the evasions were not too serious and that there would be reasonable self-policing on the part of member banks if backed by encouragement in that direction from time to time. There were some areas of supervisory work where he felt that the interests of a large number of banks must be regarded as superior to the wishes or convenience of the Federal Reserve System. In his opinion this was one of those areas. The wishes expressed by the banks who had most at stake should not be ignored.

Chairman Martin then made certain comments that went beyond the immediate question but used it as an illustration of the broader problem with which he was importantly concerned. In effect, this broader problem had to do with the manifold responsibilities of the Federal Reserve System and the proportion of time required to be devoted at various

levels, including the level of the Board of Governors, to matters in the area of bank supervision, thus impinging on the time available for consideration of monetary and credit policy. The Chairman expressed apprehension regarding the ultimate outcome in terms of the status of the Federal Reserve System as the agency of the Government primarily responsible for the regulation of money and credit. There was also implicit in his comments a note of substantial concern regarding the future of the American banking system under the existing Federal bank supervisory structure. These circumstances, he felt, suggested a strong need for those holding positions of responsibility in the System to give serious consideration to the problem he had outlined with a view to endeavoring to arrive at a solution that would be in the best interests of both the central bank and the commercial banking system. In concluding his comments, the Chairman reiterated that within the context of these remarks the question of exchange absorption, of itself important from the standpoint of the banking system, was used merely to point up by way of example the outlines of a more far-reaching problem.

The meeting then adjourned.



Secretary