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Minutes for April 4, 1962

To: Members of the Board

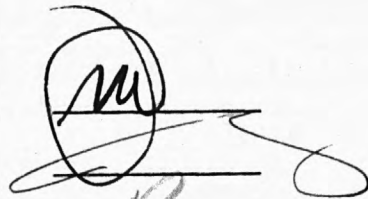
From: Office of the Secretary

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

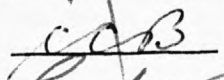


Gov. Mills

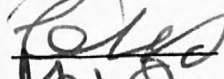
Gov. Robertson



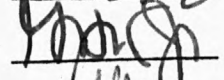
Gov. Balderston



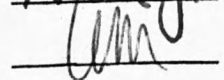
Gov. Shepardson



Gov. King



Gov. Mitchell



1/ Meeting with the Federal Advisory Council.

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Wednesday, April 4, 1962, at 10:00 a.m.

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

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

Messrs. Murphy, Petersen, Hays, Hobbs, McRae, Zwiener, Maestre, Moorhead, Breidenthal, Betts, and McAllister, Members of the Federal Advisory Council from the Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Milton H. Glover, President, Hartford National Bank and Trust Company, Hartford, Connecticut

Mr. Prochnow, Secretary of the Federal Advisory Council

Mr. Korsvik, Assistant Secretary of the Federal Advisory Council

In the absence of Mr. Enders, Member of the Council from the First District, Mr. Glover represented that District at this meeting.

The Council was in receipt of a letter from the Board dated March 21, 1962, in which the Board noted its concern of long standing regarding the difficulties involved in enforcing its position that absorption of exchange charges by member banks

4/4/62

-2-

involves an indirect payment of interest on demand deposits. Also, the Board was aware of the inequities of a situation in which member banks and nonmember insured banks were subject to different rules under similar provisions of law. In recent months, further studies 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 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. Enclosed with the letter was a memorandum summarizing the history of the matter and indicating some of the arguments that might be advanced for and against reversal of the position that absorption of exchange charges constitutes a payment of interest.

This meeting had been called in order that the Board might have the benefit of the views of the Federal Advisory Council.

In introductory comments, Chairman Martin indicated that the Board was concerned about the difficulty of enforcement of its position

4/4/62

-3-

in the absence of a uniform point of view among the Federal banking agencies. He thought it fair to say that no one in those agencies was in favor of nonpar banking. Certainly, the Comptroller of the Currency was not in favor of it. As to the Federal Deposit Insurance Corporation, its position was that adoption of a position similar to that taken by the Board was not feasible from its standpoint. There had been a meeting recently of the Comptroller of the Currency, the Directors of the Federal Deposit Insurance Corporation, and the Board of Governors, and in light of the current circumstances the Board felt it would like to obtain the advice of the Advisory Council.

Chairman Martin then turned to Mr. Hackley, who commented that the problem went back to the Banking Act of 1933, which among other things prohibited member banks from paying interest on demand deposits directly or indirectly by any device whatsoever. The language of the statute was very broad, apparently by intent. It was not until the Banking Act of 1935 that nonmember insured banks were made subject to the same prohibition. In the latter Act, the Board was given express authority to determine what would be regarded as a payment of interest on deposits. Even before that, however, the question whether absorption of exchange charges represented a payment of interest had arisen, and in a published ruling the Board had taken the position that such absorption represented an indirect payment of interest if it varied with the amount of the deposit. After the Banking Act of 1935 was passed both the Board and the Federal Deposit Insurance Corporation drafted regulations under



4/4/62

-4-

their respective statutes regarding the payment of interest, and for the first time a conflict between the two agencies arose. The Board would have declared that absorption of exchange was a payment of interest, but as a compromise the Board abandoned that provision in its regulation. In 1937, it was agreed that the question would be determined under general law as questions arose, and the Board did not exercise its statutory authority to define the payment of interest. In interpreting the general law, the two agencies continued to disagree. In connection with a particular case, the Board published in 1943 a ruling that absorption of exchange by a certain member bank was a payment of interest. This ruling provoked the introduction of a bill that would have declared absorption of exchange not to be a payment of interest, and this bill passed one house of the Congress. Since that time, efforts had been made periodically to resolve the problem between the two agencies, but without success. The Board had followed a position that if a member bank, when it collects for a depositor a check drawn on a nonpar bank, absorbs the exchange charge, the member bank is in effect making a payment to its demand depositor in the amount of the exchange charge, and that such payment involves a payment of interest on demand deposits in violation of law. On the other hand, the Board had ruled in a number of cases that when member banks provide certain free services to customers without charge, that does not involve a payment of interest to the depositor but only the omission of a charge which the bank otherwise might make for the service.

4/4/62

-5-

Many people had found it difficult to reconcile such rulings with the Board's position on absorption of exchange, since free services obviously provide a financial benefit to the depositor. Further, there might be some room for question, in interpreting the general law, whether absorption of exchange is a payment of interest, particularly with another agency of the Government interpreting the law differently.

Mr. Hackley noted that the Federal Deposit Insurance Corporation does not have specific statutory authority to determine what constitutes the payment of interest. It had relied heavily on that fact in taking the position that, even if it wished to do so, it could not define absorption of exchange to be a payment of interest. However, in a footnote to its regulation, the Corporation stated that the absorption of normal and customary charges in connection with the collection of checks is not a payment of interest. Such a statement meant, in effect, that virtually no absorption of exchange would involve a payment of interest.

In response to a question, Mr. Hackley said there was little legislative history to indicate the intent of the pertinent portions of the Banking Acts of 1933 and 1935. There was a statement by Senator Glass to the general effect that the prohibition against payment of interest on demand deposits was intended to prevent large New York City banks from drawing off funds of correspondent banks in large volume by paying high interest rates on such deposits. Senator Glass felt that this practice had been one of the contributing causes to the banking crisis; that the New York banks had used these funds for

4/4/62

-6-

speculative purposes and that this had resulted in injury not only to them but to many other banks carrying balances with them. This apparently was the reason that the law was drafted in such broad language.

In response to another question, Mr. Hackley said there was no indication from the legislative history as to whether the prohibition against payment of interest on demand deposits was aimed at preventing unsound competition between banks generally. However, this was suggested as a purpose in regulating the rates of interest payable on time and savings deposits.

Replying to a further question, Mr. Hackley reiterated that the Board has statutory authority to define what constitutes payment of interest for the purposes of section 19 of the Federal Reserve Act, while the Federal Deposit Insurance Act requires the Board of Directors of the Corporation to prescribe regulations prohibiting the payment of interest on demand deposits but does not require the Corporation to follow the Board's definition of payment of interest.

Chairman Martin commented that the Board had met last week with the Presidents of the Federal Reserve Banks on this problem, at which time one President expressed the view that the Board should stand on whatever position seemed to it to be legally and morally right. However, he (Chairman Martin) felt that the problem was somewhat broader. The question was whether the Board should stand on its position, even though that position might be legally and morally right, while discrimination continued between member and nonmember banks. This was a basic problem in the banking industry, one that it seemed necessary

4/4/62

to come to grips with one way or the other. Further, as Mr. Hackley had indicated, there might be some question whether the Board's position was legally sound; some arguments could be cited on the other side.

The Chairman then turned to Governor Robertson, noting that he had worked hard on this problem for many years, and Governor Robertson summarized negotiations that had taken place in an effort to achieve uniformity of approach among the Federal banking agencies. He recalled that for a number of years the Board had specified a rule designed to permit the absorption of exchange in relatively trivial amounts; that is, where the cost of charging back would exceed the cost of absorption. However, it developed that some banks were deviating from that rule, and the competitive problem became severe. In 1960, representatives of the three banking agencies met for the purpose of determining whether some format could be developed to which all of the agencies would subscribe. No solution was developed, however, and the matter came to a point where it appeared to the Board that perhaps an all-out effort should be made to prohibit the absorption of exchange by member banks to any extent whatever. The Board subsequently backed away from that position, because of hardships that were reported, and reestablished the so-called \$2 rule, under which member banks were permitted to absorb exchange not in excess of \$2 for any one account in any one month. A survey then was made by the Federal Reserve Banks, in cooperation with other interested parties, to determine the scope of the problem and the best way of



4/4/62

-8-

meeting it. After the survey was completed, but before a meeting of the three banking agencies could be held, a new Comptroller of the Currency was appointed. When a meeting of representatives of the three banking agencies subsequently was held, the Comptroller's representative came to that meeting instructed to say that the Comptroller was opposed to the \$2 rule and thought it should be changed. Later, during a meeting of the Board and the Comptroller on another matter, the point was made that a reversal of the Board's position could have two possible results. It could stimulate banks to charge exchange. On the other hand, the cost of absorbing exchange might be so great that the banks themselves would police the matter. In the course of that discussion, the Comptroller said that he asked only for uniformity, since national banks were being discriminated against vis-a-vis nonmember banks. Therefore, another meeting of the three banking agencies was held, but the Federal Deposit Insurance Corporation maintained that it could not change its position. Also, the Corporation was understood to feel that it had some responsibility for the protection of smaller nonmember insured banks. Thus, if the Corporation maintained its position, and if in such circumstances the Comptroller did not wish to enforce a ruling made by the Board, State member banks would be put in a disadvantageous position. The basic question was whether any agency of the Government should adopt and maintain a rule that was not enforced. Hence, the Board was considering whether it should in effect reverse its position. In thinking of the problem, it was well to keep the matter in proper

4/4/62

-9-

perspective. Although the total amount of exchange charged was not known, the best guess seemed to be about \$10 million a year. Under the \$2 rule, member banks apparently could absorb somewhat less than 5 per cent of the applicable exchange charges. If the banks were allowed to absorb exchange on items up to \$25, they could absorb up to 22 per cent of the total applicable exchange. If they were permitted to absorb exchange on items up to \$50, they could absorb up to 32 per cent. The question was whether it would not be better to go all the way and permit all exchange charges to be absorbed.

In response to a question about the concern that the Federal Deposit Insurance Corporation appeared to feel on behalf of small non-member insured banks, Governor Robertson said he could not speak for the Corporation. However, there was a tendency, he thought, for supervisory agencies sometimes to feel as though they were the guardians of the wards under their supervision. Included within the supervisory responsibility of the Federal Deposit Insurance Corporation were a large number of small banks, some charging exchange and also making service charges. The Corporation might feel that the inability to charge exchange could affect the soundness and profitability of some of those banks.

In reply to another question, Governor Robertson again said that the present Comptroller of the Currency held the view that in the current circumstances, the Board's position should be reversed. At times in the past, he noted, both the Board and the Comptroller had

4/4/62

-10-

attempted vigorously to enforce the Board's rule, but at other times the efforts of the national bank examiners had been less vigorous. In any event, a ruling of the Board could hardly be enforced effectively without the support of the Comptroller.

Further on this point, Chairman Martin repeated his previous comment that the Comptroller was not in favor of nonpar banking. On the other hand, the Comptroller had indicated that he was not prepared, under present circumstances, to try to enforce the Board's present rule. This presented a problem. An alternative approach might be to seek legislation, but the prospects of obtaining legislation appeared rather doubtful, particularly if the three Federal banking agencies did not present a united approach.

The Chairman then turned to President Murphy, who said that the Advisory Council had held a lengthy discussion of this subject last evening. The Council realized that this was a difficult problem. Every member felt that the position of the Board over the years had been a sound one; that the absorption of exchange charges was in effect the payment of interest on demand deposits. There were varied opinions as to the most appropriate course of action at this point, and it was generally recognized that there was no simple solution. The existing situation had led to undesirable inconsistencies of practice, which was a fault of the banking community. Actually, however, the problem seemed to be solving itself, even though slowly, as indicated by the gradual reduction in the number of nonpar banks. Almost everyone would agree that a banking system composed entirely of par banks was the

4/4/62

-11-

goal that ought be be achieved in due course. Even now there were certain pressures, both Governmental and commercial, that were moving in this direction, but the process admittedly was a slow one. There were many small banks that depended heavily on exchange charges for income, and the elimination of that source of income might in some cases present a problem. On the other hand, nonpar banking was abolished many years ago in the State of Iowa, and with the substitution of service charges the banks came out satisfactorily and were still earning money. The same thing had happened in other States. Nevertheless, the Board was faced with a practical problem. The Council was sympathetic, and it applauded the Board for its many attempts to reach a solution. The Council found it difficult to understand the attitude of the Federal Deposit Insurance Corporation. Prior to this meeting the Council was not aware of the position that the Comptroller had taken, and his attitude also was rather difficult to understand.

The Council appreciated the view of the Board that a ruling should either be enforced or eliminated, President Murphy continued. It would not be good for the banking system or the country to go along with a ruling that was not enforced, and this argued against just sitting tight. Each member of the Council had received a letter from the Secretary of the Bank Management Commission of the American Bankers Association dated March 29, 1962, urging, in effect, a position of "holding the line." The question was whether such a position was realistic. Some banks were trying to live up to the law, while others



4/4/62

-12-

were disregarding it. Further, contrary to the view of the Advisory Council, some bankers did not regard the absorption of exchange as a payment of interest; such a view was expressed recently by an officer of a large New York bank. The attitude of some bank examiners also seemed to indicate that they had doubts.

As to the question of reversing the Board's position, President Murphy said that this did not seem to him to be a good solution because he thought it would tend to perpetuate nonpar banking. It was possible, of course, that a reversal of the Board's position could work in the other direction, but he had grave doubts. Instead, he felt that a reversal of the Board's position would remove the pressure on nonpar banks to become par institutions. If this reasoning was correct, such an action would serve as a set-back in the evolution of the banking system as a whole.

President Murphy then turned to the question whether there was any common-sense intermediate solution and said that, after studying a quantity of survey and other material, he had come to favor a proposal with which some of the Council members would agree but others would not. This proposal, which was supported by the New York Clearing House Association, and which he thought could muster substantial support throughout the banking industry, was to permit the absorption of exchange on items in the face amount of \$50 or less. Surveys that had been made seemed to indicate that, from a cost standpoint, the break-even point in charging back exchange was on items somewhere between \$50 and \$100. The

4/4/62

-13-

small nonpar banks would not be hurt by such a solution; in fact, they would reap some profit, which he did not particularly relish. However, the larger banks in nonpar areas that process a substantial volume of nonpar items would benefit, because they would not have to keep detailed records with respect to small items.

In recommending this plan, President Murphy said he was not speaking for the Federal Advisory Council, but only as one member of the Council. The plan amounted to "begging for time," with the hope that some day the whole problem could be solved by a united approach on the part of the Government agencies concerned. However, a reversal of the Board's position would in his opinion beg the question completely and be detrimental to the well-being of the banking system as a whole.

President Murphy then turned to Mr. Moorhead, who commented that there were more nonpar banks in the Ninth District than any other District. The exchange charges on items processed by his bank alone amounted to over \$1 million a year. He did not see, if the Board's interpretation of the law was correct, that it would be right to permit the absorption of exchange on items up to \$25 or \$50, or \$100. The \$2 rule was quite different; it involved trivia. As to the comparison of exchange absorption with the providing of various free services, he again saw a significant distinction. Speaking for Ninth District banks, he would like to see the Board's present rule maintained without change. There was no difficulty with enforcement in the Ninth District, where the rule was scrupulously observed. Reversal of the Board's position would

4/4/62

-14-

remove a severe restraint on nonpar banking, because in his opinion city correspondent banks would have to absorb all exchange charges under competitive pressure. Banks outside the Ninth District would be likely to go to large accounts and offer to absorb exchange if the Ninth District banks did not agree to do it.

Mr. Petersen said that this was not too important a matter in the Third District, where there were no nonpar banks. According to the weight of opinion, it was a great deal of bother and expense to the banks to charge back exchange. Therefore, those holding that opinion would like to see the position of the Board reversed. By the absorbing of exchange charges freely, the existence of nonpar banking was made easier, because this tended to free nonpar banks from the pressure of corporate customers, which had been a factor in the erosion of nonpar banking. Banks would resist absorbing such charges if they were permitted to do so, and this might be a pressure working against the extension of nonpar banking. Accordingly, as a spokesman for the Third District, he would favor a reversal of the Board's position.

Mr. Petersen added that there had been real difficulties in terms of nonmember banks providing various kinds of free financial services, such as services for municipalities. Bankers seeking to observe the spirit of Regulation Q sometimes were prejudiced by being too cautious. He would favor doing away with Regulation Q in all respects, including the regulation of maximum permissible rates of interest.

4/4/62

-15-

Mr. Zwiener noted that there were no nonpar banks in the Seventh District. On the basis of such checking as he had done, Seventh District banks would like to see the line held where it was. This thinking went back to a fundamental point: that nonpar banking was not consistent with good banking in this country. The feeling was that it should not be made easier for nonpar banking to expand, and Seventh District banks would feel strongly that a reversal of the Board's position would represent a move backward. If the present rule was not enforceable at this juncture, that was unfortunate. However, if the Comptroller could be persuaded to join in enforcement, the other part of the problem would not be so important and time would work in the Board's favor.

Mr. Glover expressed agreement with Mr. Zwiener's comments. He would strongly urge retention of the \$2 rule, even at the risk of discrimination between classes of banks. He noted that there were no nonpar banks in the First District.

Mr. Hays said that he had been in touch with the larger banks in the Fourth District and that, with two exceptions, they were unanimous in feeling that the Board would be stepping backward if it reversed its position. In his own thinking, he had tried to reconcile the apparent inconsistency in failing to charge for some services and retaining a rule against absorption of exchange. As to the purpose of the legislation prohibiting the payment of interest on demand deposits, it had been the view of his bank's counsel, with which he agreed, that



4/4/62

-16-

the purpose was to prevent crippling competition between banks. He had not understood that the legislation appeared to have been directed primarily toward New York City banks, but he remembered vividly the situation that existed in the 1930's. Thinking in those terms, it would appear to him that the free services the Board had gone along with were appropriate, because they were not of consequence as far as crippling competition was concerned. However, the total of exchange charges ran into large figures. There was no question in his mind but that a reversal of the Board's position would remove a great deal of the pressure that now existed toward the elimination of nonpar banking. Accordingly, he felt that such a move would be unfortunate.

Mr. Hobbs said it was the general opinion in the Fifth District that a change of the Board's position would reverse a trend that had been progressing satisfactorily and that a number of present par points would become nonpar. As long as nonpar banks could find someone to absorb their exchange charges, they were certainly going to do it. Accordingly, he would be opposed to any compromise or change in the present position of the Board. As to enforcement, he did not recall ever having the question brought up by examiners, but he did not know of violations by national banks in the Fifth District. He had been told that the total amount of exchange charges at the present time might be about \$9 million and that in the Fifth District something like \$2 million was charged back. He understood that two banks in

4/4/62

-17-

North Carolina were presently charging back \$1.1 or \$1.2 million; one bank in South Carolina about \$300,000; and the Richmond banks about \$250,000 in the aggregate, with the remainder scattered.

If absorption of exchange should be permitted, it was felt that these amounts would be an outright loss for the banks concerned.

Mr. McRae reported that he had canvassed 35 banks in 15 cities in the Sixth District for their thoughts as to whether the Board should reverse its position. Twenty-five said that in their opinion the Board should not. Ten--all but one in relatively small communities--had an opposite view. The general view was that, disregarding the immediate dollar aspects of a change of position, this would represent a move toward less restricted competition. None of the bankers, he felt sure, liked regulation in principle. Nevertheless, they believed it would be unfortunate from the standpoint of the banking business as a whole to relax this particular restraint. It was the general view that if the Board's position should be reversed, there would be a fairly rapid shrinkage in the par list.

Mr. Maestre said that the St. Louis banks would not want any change in the present rule. What worried him was the reported attitude of the Comptroller. If the Comptroller was going to permit national banks to absorb exchange when and as they liked, that could create a serious situation. Personally, he favored the \$2 rule. Speaking for his own bank, it was felt that any rule laid down by the Federal Reserve should be observed. If it was necessary to compromise to some

4/4/62

-18-

extent, perhaps the \$2 rule could be relaxed, but in principle he thought it was right. He could not see that there was a proper comparison between absorbing exchange and paying certain incidental expenses that are related to servicing an account. The two things appeared to him to be in different categories.

Mr. Breidenthal expressed the view that this was a problem for which there probably was no perfect solution. Anything the Board might do would be subject to criticism from some source. The ideal was par banking, but that could not be achieved at this point; it would take a lot of education before legislation could be obtained. In effect, the current situation amounted to subsidizing certain points, as in the Sixth and Ninth Districts. The Tenth District was quite clean on this score, with only a handful of nonpar banks. He had thought that a few District banks, because of the national character of their business, handled a lot of nonpar items, but that was before he heard the figures for Mr. Moorhead's bank alone.

The Board had interpreted the law in good faith over a period of many years, Mr. Breidenthal added, and had issued rulings that it thought were right and good for the banking industry. The question was whether that position should be changed at this time under pressure. In his opinion, if the status quo was maintained, the Board would receive the support of the banking industry throughout the country to a far greater extent than any change in its position would be supported. It was unfortunate that apparently there could not be rigid enforcement. Nevertheless, he felt that most member banks

4/4/62

-19-

would support the Board if it maintained the status quo.

Mr. Betts said that, speaking as a representative of the Eleventh District, he would be in favor of the proposal outlined by President Murphy as a practical effort to meet the problem. The \$2 rule was a compromise, and the proposed exemption of exchange on items up to \$50 would be simply a more substantial compromise. The present rule was not being enforced in the Eleventh District; there was no secret about that. The larger banks with whom he had contact were, so far as he knew, abiding by the present rule, and they would favor some relaxation. From studies with which he was familiar, including the Federal Reserve survey and the New York Clearing House study, the \$50 figure was somewhere near the break-even point. If the collection of exchange on items above \$50 did not represent a loss on the part of the banks, then it would seem to be a practical move to make the further compromise and exempt the absorption of exchange on items up to \$50 in an effort to be realistic. As a general proposition, he felt that banks in the Eleventh District would welcome such a change.

Mr. McAllister commented that, except for two banks in Alaska, there were no nonpar banks in the Twelfth District. Therefore, this was not a pressing problem. Some bankers with whom he had talked expressed the view that under the present \$2 rule the costs of collecting exchange probably were as great as though the rule was not in effect. At the same time, they would regret to see it tightened. By and large, he would favor the views expressed by other members of the Council in



4/4/62

-20-

favor of the \$50 rule, which would eliminate a lot of tedious bookkeeping. As he talked with bankers, they were inclined to ask why the Board did not look into the matter of armored car service and deposit pickup service. On the West Coast, some of those things loomed larger from the cost standpoint than the question of exchange charges.

Chairman Martin commented at this point that it was important that the Comptroller's position not be misinterpreted. As he had said before, the Comptroller clearly was not in favor of nonpar banking. As to exchange absorption, however, he emphasized the need for consistency of application and the problem of enforcement. If the Board's position was reversed, the Comptroller would favor issuing a statement emphasizing support of par banking and expressing the hope that the reversal of position would not lead to an increase in nonpar banking.

In response to a question, Chairman Martin said that it seemed rather doubtful whether reasonable compliance was being obtained at the present time. He had raised the question last week at a conference of representatives of the Reserve Bank Examination Departments, and they were dubious.

In further discussion, Chairman Martin expressed the personal view that the banking industry was approaching a crossroads. There were outmoded banking laws in every State of the Union. From the standpoint of bank supervision, the Board of Governors, as an example, was spending a great deal of its time on bank supervisory work at the expense of monetary policy. In his judgment, such a situation

4/4/62

-21-

could lead to serious difficulties for the banking business. In its Annual Report for 1938, the Board discussed the problem of overlapping supervision, but the situation had just drifted along. Through good fortune it had been possible to maintain relatively good working relations among the banking agencies over the years. However, the new Comptroller of the Currency saw a great many inconsistencies in the picture. Many of them had just been permitted to grow. One of the current questions involved the cost of examinations of national banks. On the surface there might appear to be an inequity because State member banks are not charged by the Federal Reserve for their examinations. However, if one tried to correct the inequity, the difficulties might only be compounded. Further, the Board did not feel that the Federal Reserve, under present law, would be justified in contributing to the expenses of the Comptroller's Office. In a sense, the money that the Federal Reserve would contribute was actually the Treasury's money. Thus, there was a bundle of inconsistencies, of which the exchange absorption problem was just one manifestation. If the Board should go along on the basis that its position was legally and morally right, but if at the same time its position could not be enforced, before long such a situation might bring disrepute on the banking business generally.

The Chairman went on to remark that in discussions of subjects of this kind comments often were made about the effect on the dual banking system. He believed that this deserved careful thought. With three Federal banking agencies and 50 State supervisory authorities

4/4/62

-22-

trying to work out satisfactory relations with each other, the result had usually been a compromise, which raised the question whether the present bank supervisory system was completely workable. Thus, while the problem under discussion was important, it must be thought of in a broader perspective. It would be desirable if the members of the Advisory Council would consider the broad problem and help with it.

With further reference to the absorption of exchange, President Murphy inquired whether, if the Board could come up with a compromise that seemed enforceable, the Comptroller might not agree to go along and try to enforce it, to which Chairman Martin replied that he did not know. That could, of course, be explored with the Comptroller.

President Murphy then spoke in terms of the \$50 item approach as appearing to simplify the enforcement problem a great deal. The crux of the criticism seemed to be that it was ridiculous to do a lot of work to collect exchange charges that did not equal the cost of collection. There were knowledgeable people who maintained that the break-even point was around \$50. If they were right, he wondered whether a proposal incorporating the present \$2 rule, along with a \$50 cutoff, was not worthy of consideration. If such a proposal was reasonably enforceable, and the Board and Comptroller attempted to enforce it, that might go a long way toward solving the problem.

Summarizing what he understood to be the prevailing sentiment at the meeting of the Advisory Council last evening, President Murphy said that the majority opinion favored no change in the Board's present rule. However, there was a feeling on the part of some members

4/4/62

-23-

of the Council that in addition to the present \$2 monthly absorption allowance, the absorption of exchange charges on items of \$50 or less might be in the public interest. Also, the Council felt strongly that such rules as were finally determined by the Board should be rigidly enforced.

In substance, President Murphy said, that was the way the Council felt. There was no solution that was going to come overnight. However, if the Comptroller could be convinced that there was a reasonable rule that would be enforceable, he thought that might go a long way toward solving the problem. When it came to the \$2 rule standing by itself, there were many people who felt that it was foolish to keep detailed records. In his opinion, however, the alternate proposal could be defended. If the Comptroller felt that it could be enforced, it might be worth a try.

Governor Shepardson said he understood that the Comptroller's position was founded not in the difficulty of enforcing any particular rule but in the inequity of any rule that applied to member banks and not to nonmember banks, and Governor Balderston agreed that the question of consistency appeared to be uppermost in the Comptroller's mind.

Mr. Hays said he did not see any way that the Federal Deposit Insurance Corporation could be brought into line at the present time. However, it was his feeling that if the Comptroller and the Federal Reserve were to agree on a course of action, sooner or later the Corporation would come in line. At the same time, pressure would be



4/4/62

-24-

maintained looking toward the gradual reduction of nonpar banking.

Mr. Moorhead suggested that about 95 per cent compliance might be more important than consistency in this case.

President Murphy then caused to be distributed (1) a map of the United States showing the concentration of nonpar banks, (2) a tabulation of States classified according to the percentage of nonpar banks therein, and (3) a tabulation showing the effect of various alternate rules for the absorption of exchange charges. Referring to the last-mentioned tabulation, he noted that for a one-month period, based on the survey of 111 banks by the Federal Reserve System, there were a total of about 4,749,000 nonpar items of \$25 or less, on which the exchange amounted to about \$160,000 and the cost of collecting the exchange was estimated at \$221,000. Thus, it would cost the banking system about \$61,000 to collect these charges. For items of \$50 or less, the total number was 5,818,000, the amount of exchange was \$221,000, and the cost of collecting \$272,000. For items of \$100 or less, the total was 6,583,000, the exchange \$285,000, and the cost of collecting \$308,000. The profit to the banks from collecting exchange on items over \$100 would be about \$4,652,000 on an annual basis. If a break-even point could be found that people felt was fair and reasonable, it might be possible to convince the Comptroller that enforcement was feasible.

Governor Mills noted that the ruling, as it now stood, applied on an account basis and not on a per item basis. If there was an

4/4/62

-25-

account with a large number of items of \$50 or less and full absorption was permitted on all such items transmitted through that account, then the amount that could be absorbed for that particular account would come to quite a substantial sum of money.

With regard to the question of enforcement, Governor Mills commented that if a bank abided by the Board's rule and found that a competitor was approaching an account and offering to render service at less cost, somebody was going to do something about it. The whole banking community was in a degree an enforcement mechanism in its own self-interest.

In further discussion, question was raised whether, in the absence of a sympathetic attitude of the Comptroller toward enforcement, the maintenance of a restrictive Board ruling would be justified.

Mr. Hays said he felt personally that the Federal Reserve should hold the line, because its position was fundamentally sound for the banking system. He thought it could be demonstrated that there would be less inequity for the banking system as a whole if the Comptroller sided with the Federal Reserve rather than with the Federal Deposit Insurance Corporation. Apparently there was no possibility of obtaining a completely uniform view on the part of the banking agencies unless the Board changed to the position of the Corporation, and he thought that would be wrong.

Governor Robertson commented that the Comptroller had said that he felt nearly every national bank in the country would welcome a reversal of the Board's position, and a number of members of the Council

4/4/62

-26-

indicated that they felt the Comptroller's understanding was erroneous.

Turning to the broader problems to which Chairman Martin had referred earlier, Mr. Petersen inquired whether there was any plan for hearings by the Banking and Currency Committees on the recommendations of the Commission on Money and Credit, and Chairman Martin replied that he knew of none. However, pursuant to the President's Economic Message to the Congress, three interagency committees were being set up to make studies and recommendations, as announced in the press this morning, against the background of the Commission's report and other factors.

The comment also was made that in the event legislation should be introduced to authorize or require the Federal Reserve System to contribute to the cost of national bank examinations, there would be a question as to what position the Federal Reserve should take. However, Chairman Martin noted that this was not a question on which the Council should be asked for an offhand opinion.

President Murphy then reverted to the subject of exchange absorption and inquired whether it would serve a purpose if national banks would get in touch with the Comptroller to express their views. This was a two-sided question, but there should be room for a meeting of the minds and some in-between solution.

Chairman Martin replied in terms that he had no question about the Comptroller's sincerity of purpose. In his (Chairman Martin's) opinion, there were a lot of cobwebs in the Comptroller's job that had been accumulating for some time. In his judgment, there had not

4/4/62

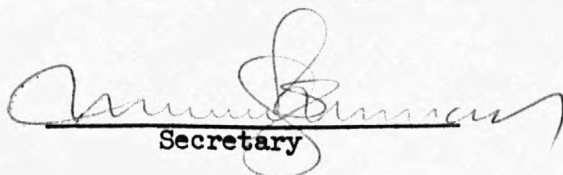
-27-

always been a seeking of the right answer to these problems. There had been a tendency to compromise, and eventually that could lead the banking industry into a serious state of disrepute. Thus, everyone should properly be concerned. The Council members ought to be thinking, particularly, about discouraging associates from talking in terms of destroying the dual banking system if that was not really at issue. The necessity was to reach a workable set of arrangements, and everyone had a responsibility to face up to that problem.

Inquiry was made whether there would be objection to members of Council reporting on this meeting at the meetings of the respective Federal Reserve Bank boards of directors, and Chairman Martin indicated that there would be no objection. He added that there was some difference of views among the Reserve Bank Presidents on the exchange absorption question. A number of Presidents were not in accord with the view of the Reserve Bank President to whom he had referred earlier during this meeting. The objective of the Board, he added, was to go into this problem carefully and think it through, including the longer-run implications. His associates on the Board of Governors shared his concern about the seriousness of the general problem.

President Murphy said, in a concluding comment, that whatever the decision of the Board might be, the Council would recognize that it represented the Board's best judgment. He felt that the banking industry would support it.

The meeting then adjourned.

  
Secretary