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Minutes for April 6, 1962

To: Members of the Board

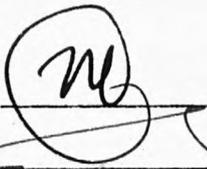
From: Office of the Secretary

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

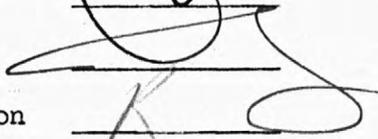
It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

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.

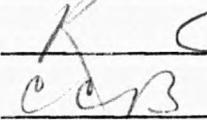
Chm. Martin



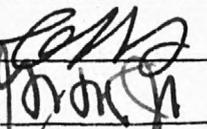
Gov. Mills



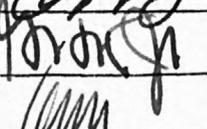
Gov. Robertson



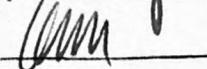
Gov. Balderston



Gov. Shepardson



Gov. King



Gov. Mitchell

Minutes of the Board of Governors of the Federal Reserve System on Friday, April 6, 1962. The Board met in the Board Room 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. Thomas, Adviser to the Board
Mr. Young, Adviser to the Board and Director,
Division of International Finance
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Noyes, Director, Division of Research
and Statistics
Mr. Holland, Adviser, Division of Research
and Statistics
Mr. Koch, Adviser, Division of Research
and Statistics
Mr. Yager, Chief, Government Finance Section,
Division of Research and Statistics

Money market review. Mr. Yager reviewed recent developments in the Government securities market, following which Mr. Thomas commented on bank credit and related matters.

Messrs. Thomas, Young, Holland, Koch, and Yager then withdrew from the meeting and the following entered the room:

Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Goodman, Assistant Director, Division of
Examinations
Mr. Leavitt, Assistant Director, Division of
Examinations

4/6/62

-2-

Mr. Veret, Attorney, Legal Division
Mr. McClintock, Supervisory Review Examiner,
Division of Examinations

Discount rates. The establishment without change by the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, St. Louis, Kansas City, Dallas, and San Francisco on April 5, 1962, 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.

Purchase of shares by Edge corporation (Item No. 1). Pursuant to the favorable recommendation contained in a memorandum from the Division of Examinations, which had been distributed to the Board, unanimous approval was given to a letter to Morgan Guaranty International Banking Corporation, New York, New York, granting consent to the purchase of shares of China Development Corporation, Taipei, Taiwan, China. A copy of the letter is attached as Item No. 1.

Mr. Goodman then withdrew from the meeting.

Cost of examinations of national banks (Item No. 2). Under date of March 6, 1962, and again under date of March 16, 1962, the Comptroller of the Currency had addressed letters to the Board with regard to his desire that the Federal Reserve System make contributions toward the cost of examinations of national banks. In the interim, on March 13, 1962, the Comptroller met with the Board of Governors. On the basis of statements made and questions raised in the March 16 letter, there had been distributed to the Board a draft of reply.

4/6/62

-3-

After some discussion of the position that it would seem most appropriate for the Board to take, the proposed reply was approved unanimously, subject to a minor change in the final paragraph. A copy of the letter sent pursuant to this action is attached as Item No. 2.

Mr. Hexter then withdrew from the meeting.

Interagency committees. Pursuant to his Economic Report to the Congress, the President of the United States had established three interagency committees to study various implications of the report of the Commission on Money and Credit. The first of these committees was to study financial institutions, the second was to study Federal credit programs, and the third was to study corporate pension funds and other private retirement and welfare programs. The Chairman of the Board of Governors was named as a member of each of these committees.

Chairman Martin stated that the committee set up to study financial institutions had held an initial organizational meeting and that he had requested Mr. Noyes to attend. At the Chairman's request, Mr. Noyes then presented a brief summary of the proceedings at the meeting. Among other things, he stated that several background papers of a factual nature had been requested relating to the subjects into which the committee proposed to inquire, and that he had agreed that certain of them would be prepared by the Board's staff.

Chairman Martin then noted receipt of a letter from Secretary of the Treasury Dillon dated April 5, 1962, noting that he (Mr. Dillon)

4/6/62

had been asked to chair the committee that would study Federal credit programs and that he was asking Mr. Roosa, Under Secretary for Monetary Affairs, to represent him in initiating the work and arranging an organizational meeting of the group on Monday, April 9. The person who was to represent the Board at the meeting was asked to be in touch with Mr. Roosa.

Chairman Martin commented that the question of representation at the initial meeting of the committee on financial institutions had come up hastily. He proposed that Mr. Noyes also be the Board's liaison with the other two committees, subject to review of the matter by the Board at a later date in the light of developments.

It was indicated that this procedure would be satisfactory to the other members of the Board.

Messrs. Molony, Fauver, Noyes, and Farrell then withdrew from the meeting.

Applications of Chemical Bank New York Trust Company and Chase Manhattan Bank. Chemical Bank New York Trust Company, New York, New York, had applied for permission to merge with Long Island Trust Company, Garden City, New York, and to operate branches at the present offices of Long Island Trust Company. The Chase Manhattan Bank, New York, New York, had applied for permission to merge with Hempstead Bank, Hempstead, New York, and to operate branches at the present offices of Hempstead Bank. These applications were analyzed by the Division of

4/6/62

-5-

Examinations in memoranda submitted to the Board under date of November 20, 1961. In each instance the recommendation of the Division was favorable. Subsequently, the Board decided to hold public oral presentations on these applications, and such presentations were made to the Board on January 19, 1962.

Under date of March 12, 1962, the Division of Examinations submitted a new memorandum on these cases, in light of the oral presentations and all other available information. The Division now recommended that both proposals be denied. The material to which reference was made in the new memorandum included a letter from the Comptroller of the Currency dated January 22, 1962, in which the present Comptroller, reversing the position of his predecessor, recommended adversely on these applications. Chemical Bank and Chase Manhattan had each replied to the Comptroller's letter under date of February 1, 1962, and copies of their letters also were attached to the memorandum, together with a letter from the Department of Justice dated February 27, 1962, in which the view was expressed that the proposed mergers would violate the provisions of section 18(c) of the Federal Deposit Insurance Act, as amended, and would raise serious questions under the antitrust laws.

A memorandum from the Legal Division dated March 20, 1962, submitted a summarization of arguments that might be made for and against approval of the applications. It was the view of the Legal Division that there was evidence in the record that would support decisions by the Board either approving or disapproving the applications.

4/6/62

-6-

It was believed that Board decisions either way in these cases could not be successfully challenged as unsupported by substantial evidence. In light of the aforementioned letters from the Comptroller of the Currency and the Department of Justice, the memorandum from the Legal Division contained a review of the legislative history of the bank merger statute insofar as it related to reports on competitive factors involved in merger applications, in the thought that this might be helpful to the Board in considering and determining what weight to give to the reports received in the Chase and Chemical cases.

At the beginning of the discussion of these matters, the Chairman turned to Mr. Solomon, who said that the Division of Examinations had tried to determine whether there were any substantial grounds for distinction between the two cases. Its conclusion was that the cases were not distinguishable; no basis was seen for approving one application and disapproving the other.

It had been brought out by the Division's memoranda, Mr. Solomon noted, that there was substantial competition between the New York City bank and the Long Island bank proposed to be acquired in each of these cases. Unless there were offsetting advantages, that would seem to provide a strong reason against approval. At the time the Division submitted its initial memoranda, it had been impressed by what seemed to be substantial offsetting considerations. First, there were two banks (Franklin National Bank and Meadow Brook National Bank) that had substantial positions in Nassau County, both separately and in combination. On June 30, 1961, Franklin

4/6/62

National had 41 per cent of Nassau County deposits and Meadow Brook had 23.4 per cent. As to commercial banking offices in the County, Franklin had 22.6 per cent and Meadow Brook had 29 per cent. It had seemed to the Division that there was some merit in the contention of the applicants that they would offer improved services in the County, probably at lower rates. Further, there were on file at that time reports from the Comptroller of the Currency and the Federal Deposit Insurance Corporation expressing the view that the proposed mergers would have no particularly adverse effects on competition.

The Division had regarded these as close cases, and it recognized the similarities between them and an application by the First National City Bank of New York City to merge with the National Bank of Westchester, a bank in Westchester County. (On the Westchester application, the Board took an adverse position on competitive factors in its report to the Comptroller; and the application was subsequently denied by the Comptroller.) However, it had seemed to the Division that approval of the two applications now before the Board would be warranted.

Turning to the reasons why the Division now recommended denial, Mr. Solomon indicated that the change resulted principally from a critical review of information developed at the oral presentations, including information presented on behalf of the applicants. Also, the Division felt that the views of the present Comptroller of the Currency were entitled to some consideration.

4/6/62

-8-

Mr. Solomon went on to suggest that the strength in Nassau County of Franklin National and Meadow Brook National could easily be overemphasized. The Division felt, in fact, that it was overemphasized by President Rockefeller of Chase Manhattan at the oral presentation. The presentation of Mr. Rockefeller carried a general connotation that the Nassau County area had practically been cartelized through an arrangement between Franklin and Meadow Brook. On closer analysis, however, this was not so clear. First, such an arrangement would not have been strictly within the power of those banks; their branches had to be approved by the Comptroller of the Currency. Second, it was not clear that all of the 20 communities in which Franklin and Meadow Brook alone had offices could support branches of other institutions. Third, if those communities could support other branches, they were open to the establishment of such offices; there was no home office protection. It was the opinion of the Division that there was not such a monopolistic situation in the area as might be imagined. Further, to the extent that any such situation existed, the proposals before the Board would do nothing substantial to correct it.

Furthermore, Mr. Solomon said, the evidence purporting to show that improved services would be available in Nassau County if the current applications were approved was not convincing to him. It appeared from the oral presentations that the services of the present Nassau County banks and of the applicant New York City banks were perhaps

4/6/62

-9-

more comparable than had previously appeared to be the case, and that the rates for services likewise were more comparable.

Mr. Solomon next turned to the views presented at the oral presentation on behalf of Chemical Bank by Francis A. Florin, former Deputy Superintendent of Banks of New York State, regarding the feasibility of expansion into Nassau County through de novo branches. This testimony was to the effect that the soundness of additional de novo branches was open to question, that Nassau County was now fully banked, and that it offered little hope or opportunity for such branches. In Mr. Solomon's view, this analysis was subject to the defect of being a static analysis of a dynamic situation. In any area where there were aggressive banks, and particularly where branch banking was permitted, a case probably could be made at any given point in time that the area was saturated. However, area growth created a need for additional facilities. The Nassau County area showed a 93 per cent increase in population from 1950 to 1960.

Finally, Mr. Solomon said, the Division of Examinations felt that some attention should properly be paid to the views of the present Comptroller of the Currency. The bank merger legislation specifically provided for the exchange of reports on competitive factors between the Federal banking agencies, the reason being not merely to insure equity among different classes of banks, because equity could be achieved through the process of banks moving to the supervisory system that provided the most lenient treatment. Instead, the legislative history

4/6/62

-10-

suggested that the Congress was concerned that one bank supervisory agency not follow more lenient standards than another agency. For this reason, it seemed that an adverse report was entitled to more attention than a favorable or noncommittal report. Further, consistent with his recommendations on the Chase and Chemical cases, the Comptroller had turned down the application of First National City Bank to merge with the National Bank of Westchester. Admittedly, that case could be distinguished from the Chase and Chemical applications; the concentration factor was not as great in the latter cases as in the Westchester case. However, when the supervisory agency charged with direct responsibility not only for reporting on competitive factors but deciding applications took a position in favor of entry by de novo branching rather than merging, at least on any substantial scale, Mr. Solomon felt that those views were entitled to considerable weight.

Summarizing the reasons why the Division of Examinations now recommended disapproval of the two applications, Mr. Solomon said that, since there appeared to be reasonably good banking services in Nassau County at the present time, there seemed to be no strong reason to eliminate the substantial competition between the applicant banks and the Long Island banks they sought to take over by merger. The Division did not believe that this would achieve desirable results. It did believe that approval would be likely to raise policy problems with regard to the expansion of banks in the New York City area and perhaps elsewhere.

4/6/62

-11-

In a general discussion that ensued, Governor Mitchell referred to the earlier comments by Mr. Solomon to the effect that the Division of Examinations was unable to distinguish between the two cases. He inquired whether there were not, in fact, certain distinctions; for example, as between the two Long Island banks sought to be merged.

The reply by Mr. Solomon was in terms that admittedly there were differences between the two Long Island banks involved. However, while one of the banks might be somewhat stronger than the other, neither bank was a problem bank or a failing institution. The intent of his earlier comments was to suggest that the Division of Examinations could not find distinctions between the two cases of such nature as to suggest approval of the one application and denial of the other.

Governor Mitchell then directed to the Division of Examinations a series of questions relating to (1) the prospects of the two Long Island banks, particularly if the State of New York should remove the so-called home office protection rule, under which outside banks were not permitted to establish branches in a community where the head office of a local bank was located, and (2) the profitability of operations of the branches of the two Long Island banks.

On the first of the two lines of questioning, the comments by the staff were to the effect that, on the basis of the available evidence, the two Long Island banks were and could continue to be profitable and sound institutions. It was also stated that upon analysis the home office protection rule did not appear to be so

4/6/62

-12-

important a factor as might appear at first impression. As to the branch operations, one of the banks (Hempstead) had been active in establishing branches in growing communities, perhaps in anticipation of a possible merger of the bank, and it might be that one or more of those branches was not yet on a profitable basis. Detailed earnings breakdowns of the respective branches of the two banks were said not to be available to the Board's staff, and it was not known whether the books of the respective banks were maintained in such manner as to provide complete information in that regard. The only source of information, to the extent that it might exist, would appear to be the banks themselves.

Question was raised whether it would be desirable to attempt to obtain such information from the banks. It was the consensus, however, that it would be preferable to proceed to consider the applications in the light of the data already at hand.

The Chairman then turned to Mr. Hackley, who summarized the memorandum that had been prepared by the Legal Division. He noted particularly that the Division had thought it desirable to include in the memorandum some background material relating to the submission of reports on competitive factors, as required by statute in merger cases. The gist of the Division's observations was that the Congress clearly expected the three Federal banking agencies to seek a uniform approach, particularly insofar as competitive factors were concerned. At the

4/6/62

-13-

same time, the legislation did not require the Board to be bound by the views of the other banking agencies. The Board had a responsibility not to base its decisions solely on the conclusions of another agency with respect to competitive factors.

The members of the Board then presented their views, beginning with Governor Mills, who said he believed that approval of both applications was justified. In reviewing the proposals, he thought there was a danger of being unable to see the forest because of the trees; through excessive particularizing, there was the risk of losing trace of the basic reasons for which the proposals were submitted. The most persuasive factors arguing for approval were the relationships of Nassau County, geographically and demographically, to the City of New York. The population of the County (1.3 million) was substantially larger than the population of many of the States of the Union. He found it difficult to convince himself that the needs of a population of that size could not be served by the injection of larger banks from an immediately adjacent area without upsetting the competitive banking situation in the County. The two large banks--Franklin and Meadow Brook--would be considered dominating institutions if Nassau County were a State, and the introduction of other competition would be welcomed. He was impressed by Mr. Roth's statement that his bank (Franklin National) was in a position to attract out-of-County funds in substantial amount and that the bank was considering entering New York City, thus following the opposite route from that

4/6/62

-14-

proposed by Chemical and Chase, which was to move out into an area that had an affinity in all respects to the type of population they served at home. There was a wholesome prospect that banks from Nassau County would go into New York City and would be able to prosper. Similarly, it seemed to him desirable that Chase and Chemical be permitted to enter, in the limited way now proposed, into Nassau County and make their services available to a population that in some ways already looked to them for such services. Nassau County--often called the "bedroom" of New York City--deserved to be accommodated by offices of New York City banks that already provided service to many individuals residing in that County. A mistake could be made by looking at the size of the applicants and considering that their size would be transplanted in toto into Nassau County. They were not asking to move lock, stock, and barrel. They simply were proposing to supply service by means of branches and, by use of such facilities, to make their own way through the availability of the business they presently held or business that might be attracted to them in the future.

Governor Robertson said he thought the staff had stated the case well. He would disapprove both applications. It should be borne in mind that the burden of proof was on an applicant, in a merger case, to show special benefits that would result from the merger, and to show that those benefits were sufficient to offset the adverse factor involved in the elimination of competition. In each

4/6/62

-15-

of these cases, there was real and substantial competition between the applicant bank and the bank sought to be merged, not in relation to the size of the applicant bank but in relation to the size of the bank sought to be acquired. The applicant banks were not precluded from going into Nassau County by de novo branches, but in the way now proposed they would take over operating institutions. For them, it was a reasonable thing to want to do. They realized it was a good opportunity, as evidenced by the size of the premiums offered. However, the Board must look at the public interest factor, and in Governor Robertson's opinion the applicant banks had not passed the test of the burden of proof. He did not see the public benefits to be derived from their going ahead in this fashion, as balanced against the elimination of a significant amount of existing competition. In essence, the applicant banks were proposing to eliminate alternative sources of credit and banking facilities without providing benefits of substance to offset that factor. Notwithstanding the excellence of the applicant institutions, and the fact that they would do their best to provide public benefits, Governor Robertson felt that a case had not been made to justify the elimination of competition.

Governor Shepardson recalled that at the oral presentations the point was made that the establishment of de novo branches would bring in additional offices to compete with the existing independent banks. It was suggested that inevitably this would cut into the

4/6/62

operations of the small banks more than the elimination by merger of one of the existing banks. On the other hand, there might be arguments for the de novo branch approach. New branches had to earn their way gradually; the pressure on the small competing banks might be slower, even though the effect might not be substantially different in the long run. With regard to the positions of the bank supervisory agencies, a point had been made about the difficulties involved in laxity of enforcement of the bank merger legislation on the part of any one such agency. This point seemed to have some significance. Taking all factors into consideration, Governor Shepardson was inclined to favor denial of the applications.

Governor King commented that he was aware of the problems involved in lack of consistency among the bank supervisory agencies. He recalled, however, that at one time the Board was concerned about the possibility of another agency being more lenient than the Board. He could not reconcile himself to the idea of making his viewpoint necessarily coincide with that of some other agency. The Comptroller had the right to recall the other application (First National City-National Bank of Westchester), as he had indicated he might if the Chase and Chemical applications were approved. If so, any inequity could be corrected.

Governor King went on to say that he viewed New York City and Nassau County as parts of a large metropolitan area. From study of the map, it looked as though the Nassau County area was

4/6/62

-17-

saturated with offices of banks and other financial institutions, including savings and loan associations. In his opinion, it was unreasonable under present laws to expect Chemical and Chase to go in and establish branches de novo. He would prefer that they do so, but, as he had said, he would view New York City and Nassau County as parts of one metropolitan area, and the State law now permitted outside banks to go into the County. Mr. Roth had intimated that Franklin National was going into New York City. In Governor King's opinion, that would be desirable; he would like to see Franklin National go into New York City. As to the Chemical and Chase applications, he would favor their approval.

Governor Mitchell indicated that he had not yet made up his mind on the applications. He had been trying to sift the evidence. He felt, like Governor King, that Nassau County was a part of the metropolitan area into which New York City banks ought to have the right of entry. The thing that bothered him was whether the two Long Island banks (Long Island Trust and Hempstead) would be able to survive. If the evidence showed clearly that they would be able to survive, he thought that the applications should be denied. Many residents of Nassau County could now bank in New York City or the County. They now had two alternatives, but they would not have them if the mergers took place. Some could also deal with Franklin and Meadow Brook if they liked to deal with a large bank. The greater convenience of a relatively few persons would require eliminating two competing banks, and he would prefer to leave them in business. At least, his tentative feeling was

4/6/62

in that direction. He was troubled, however, by the assertions that the Nassau County area was overbanked. It was true, of course, that this area had experienced a decade of substantial growth, and he assumed that the growth would continue. He did not know whether the New York banking authorities recognized this fact, or would shortly, and therefore would permit unrestricted branching. These were generally the kinds of considerations on which he was endeavoring to make up his mind. At the moment, he would tend toward disapproval.

Governor Balderston noted that the present situation in Nassau County involved duopoly. It had been fostered by legislative barriers, now removed, that protected Franklin and Meadow Brook against the entry of outside banks. They presently held around 65 per cent of total County deposits, and Franklin had become one of the most profitable banks in the country. The entry of Chase and Chemical would tend to reduce the advantages of the two large entrenched banks and provide more specialized services to industrial firms. The most significant social gain would therefore be a quick destruction of duopoly. The question was whether the price would be too great. The Department of Justice and the Comptroller of the Currency believed it would.

As he studied these cases, Governor Balderston said, he thought the real question was whether sufficient locations suitable for new banking offices still existed. Mr. Florin had testified that Nassau County was now fully banked and that it offered little hope or opportunity for de novo branching. According to Mr. Florin's figures on

4/6/62

-19-

banking offices, which appeared to include offices of savings banks and savings and loan associations, there was one banking office to 6,085 people, which would make the County one of the most heavily banked areas in the country. On the other hand, the Division of Examinations had prepared a table indicating there were 20 communities lacking home office protection. The average population per Nassau County commercial banking office was said to be around 10,000 in June 1960, compared with 9,400 for New York State and 7,500 for the United States. Seven new branches had been started by New York City banks, which tended to indicate that some branching was feasible.

Governor Balderston also said that he had to agree with the Comptroller of the Currency that the de novo branching approach would reduce the risk of stimulating a rash of mergers. This was a very real risk, as attested by the premium being offered by Chemical for the stock of Long Island Trust Company. It was inconceivable that the successful sale of that bank and the Hempstead Bank would not induce similar attempts by other Long Island banks to sell out. If this led to the absorption of a substantial number of them, that would cause the remaining banks to claim that they could no longer attract and retain competent management. The choice facing the Board was to approve, in order to diminish the current duopoly speedily--or to deny, in order to avoid the initiation of so many mergers as to carry Nassau County banking concentration beyond the point of no return. He had come very reluctantly to the feeling that in parts

4/6/62

-20-

of California the problem had passed the point of no return, but in Nassau County that point had not been reached. The law being as it was, he would favor denial of the applications.

Chairman Martin said that, like the Division of Examinations, he had been on both sides. At one time he was clearly convinced that the line of reasoning expressed by Governor Mills was correct. There was much merit in it. However, he had now come to the view that the wiser course for banking in general would be to deny the applications. There would be a minimum of injury to the banks concerned, while he was not sure what kinds of problems might be opened up by approval. As to the Nassau County area, it was, as Governor King had said, part of the New York City metropolitan area. There was no getting away from it. Nevertheless, he found this sort of application most difficult in terms of the relative weight that should be given to the various factors involved. On balance, his final conclusion was that the wiser course would be to deny. While there would, of course, be some dissatisfaction and irritation, there would be a minimum of loss to the parties involved. The route of de novo branching might do some injury to the two Long Island banks seeking to merge, and the end result might be the same. On the other hand, he had the feeling that anything that caused bankers and businessmen to go slow on some of these operations at the present time would be of material advantage. They were moving too fast, in his opinion, on some things that probably

4/6/62

-21-

were going to come about of their own accord in due course. From the Board's standpoint, and looking at these two cases without trying to forecast the future, it seemed to him that in a sense there was a choice between two evils. In his opinion, the lesser evil would be to deny.

The members of the Board having expressed their views, there ensued a brief discussion, at the instance of Governor Mitchell, regarding the procedure to be followed at this point. Mr. Hackley recalled that the rules adopted by the Board last fall with regard to the processing of bank merger and bank holding company applications provided that there would be a discussion of the merits of an application, at which time the members of the Board would express their tentative views. Following such expressions, the Board's decision would be made and votes would be recorded. Later, when the order and statement reflecting the decision were presented, the sole action of the Board would be to approve the form of the order and statement. Obviously, the Board could change its rules. However, that would involve a departure from the uniformity of procedure that the Board was seeking last fall.

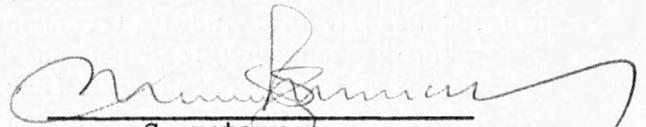
Several members of the Board expressed the view, for reasons stated, that the rules in their present form were sound, and Governor Mitchell indicated that he would be guided by the rules and cast his vote at this time.

4/6/62

-22-

A vote then was taken on the application of Chemical Bank New York Trust Company, and also on the application of The Chase Manhattan Bank. On both applications Governors Mills and King voted to approve and Chairman Martin and Governors Balderston, Robertson, Shepardson, and Mitchell voted to deny. Accordingly, both applications were denied by majority vote. It was understood that the Legal Division would draft orders and statements reflecting these decisions for the Board's consideration.

The meeting then adjourned.


Secretary

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

Item No. 1
4/6/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 6, 1962



Morgan Guaranty International
Banking Corporation,
23 Wall Street,
New York 8, New York.

Gentlemen:

In accordance with the request and on the basis of the information furnished in your letter of February 1, 1962, transmitted through the Federal Reserve Bank of New York, the Board of Governors grants consent for Morgan Guaranty International Banking Corporation to purchase and hold up to 8,000 ordinary shares, par value NT\$1,000 each, of the capital stock of China Development Corporation, Taipei, Taiwan, China, at a cost not to exceed approximately US\$200,000, provided such stock is acquired within one year from the date of this letter.

The Board's consent is granted upon condition that Morgan Guaranty International Banking Corporation shall dispose of its holdings of stock in the Chinese corporation, as promptly as practicable, in the event that the Chinese corporation should at any time (1) engage in issuing, underwriting, selling or distributing securities in the United States; (2) engage in the general business of buying or selling goods, wares, merchandise, or commodities in the United States except such as is incidental to its international or foreign business; or (3) otherwise conduct its operations in a manner which, in the judgment of the Board of Governors, causes the continued holding of its stock by Morgan Guaranty International Banking Corporation to be inappropriate under the provisions of Section 25(a) of the Federal Reserve Act or regulations thereunder.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
4/6/62

OFFICE OF THE CHAIRMAN

April 9, 1962

The Honorable James J. Saxon,
Comptroller of the Currency,
Treasury Department,
Washington 25, D. C.

Dear Jim:

This is in further reference to recent correspondence and discussions regarding your request that the Board of Governors hereafter make payments to your Office for the purpose of covering a substantial part of its expenses. You wish such payments to be made without Congressional authorization, but your letter of March 16, 1962, mentions the possibility of "legislation to accomplish the desired purpose."

In the Board's judgment, your request raises two questions that must be kept separate: (1) whether such payments by the Board to your Office would be appropriate or even permissible under existing law; and (2) the advisability of the enactment of legislation that would authorize or direct the Board to make such payments. With respect to the second question, an important related problem would be the terms of any such legislation.

(1) As has been brought out both in correspondence and in discussions, Congress has enacted legislation making quite clear that the expense of the examinations of national banks shall be paid by the national banks themselves, through assessments by the Comptroller "upon national banks in proportion to their assets or resources." (Section 5240 of the Revised Statutes; 12 U.S.C. 482) Other provisions of section 5240, and their legislative history, confirm the meaning of the basic statutory provision, which was quoted in Governor Robertson's letter of February 27, addressed to you.

In the face of a Congressional enactment providing that "the expense of the examinations" of national banks shall be paid by the banks examined, it is impossible to justify payment of the expense of national bank examinations, in whole or in part, by the Board of Governors. If the Board of Governors were to pay to your Office, for example, one-fourth of the expense of national bank examinations, this would be tantamount to interpreting section 5240 as if it provided that only "three-fourths of the expense of the examinations" of national banks shall be paid by the national banks. Regardless of views as to

The Honorable James J. Saxon

-2-

the desirability of the existing provisions of section 5240, action by the Board that would ignore Congress' enactment obviously would be inappropriate, if not, indeed, a violation of law. If section 5240 requires amendment, such amendment must be effected by Congress and not by disregard of the law on the part of either the Board of Governors or the Comptroller of the Currency.

Accordingly, the Board of Governors has concluded that it should not, under existing law, accede to the request, in your memorandum of February 8, for a periodic payment to your Office of 2 cents per \$1,000 of the total resources of all national banks (which presently would aggregate about \$2,840,000 annually). It should be noted that, if the Board were to accede to your request, the actual effect would be to transfer a substantial part of the cost of national bank examinations from those banks to the United States Treasury, since all of the earnings of the Federal Reserve System, apart from dividends and additions to surplus, are paid the United States Treasury. It would be particularly inadvisable, even if it were legally permissible, thus to divert funds from the national Treasury, in the absence of Congressional appropriation or other authorization.

Your letter of March 16 states that "we now propose as an alternative to our original proposal" that a portion of the cost of national bank examinations be borne by the Federal Reserve System, not through a payment expressly for that purpose, but through payments for copies of reports of examination ranging from \$300 for each report on a bank with resources of less than \$25,000,000 to \$5,000 for each report on a bank with resources exceeding \$500,000,000.

As pointed out in Governor Robertson's letter of February 27 and at a recent meeting with you, the Board considers that the Federal Reserve would be justified in reimbursing your Office for the full cost of making and transmitting to it copies of your reports, calculated on any reasonable cost-accounting basis. However, the amount paid for such copies necessarily would be based on the cost of copying and transmitting and not on the cost of making the examinations. The scale of charges for copies of examination reports proposed in your letter of March 16 apparently is not related to the cost of making and transmitting the copies, but constitutes an alternative procedure for Federal Reserve payment of part of the cost of national bank examinations. In the Board's judgment such an indirect departure from the intent of the applicable provisions of law would be no more justified than a direct departure therefrom.

(2) Since the Board of Governors cannot, in view of provisions of existing law, appropriately pay your Office part of the expense of examinations of national banks, a second and quite different question

The Honorable James J. Saxon -3-

is presented--namely, the advisability of the enactment of legislation that would authorize or direct the Board to make such payments.

The desirability of such legislation can only be judged in the light of (a) the factual situation to which it would relate, and (b) the specific terms of the legislation proposed. The factual situation is complicated by the nature of our commercial banking system, made up of some 14,000 banks operating under more than 50 separate banking codes and subject to as many supervisory authorities. Even from the single viewpoint of the fairness of examination costs borne by banks in competition with each other, the situation is further complicated by the fact that some banks are examined exclusively by Federal authorities, others exclusively by State authorities, others by State and Federal authorities jointly, and still others by State and Federal authorities separately. In fact, some State banks are subject to both joint Federal-State examinations and separate examinations by one of these supervisory authorities. Furthermore, the examination fees imposed by State authorities vary considerably, so that the annual fees imposed on a bank of given size in one State may be several times as large as the fees paid by a bank of similar size and character in another.

The advisability of legislation that would shift a part of the cost of national bank examinations from the banks examined to agencies of the Federal Government has been the subject of consideration on numerous occasions. In 1956, for example, your Office transmitted to the Board a draft of a bill that would have required the Board of Governors to pay to your Office annually "an amount equal to 50% of the expense incurred by it and by the federal reserve banks in examining state member banks." At that time, the Comptroller's staff and the Board's staff prepared schedules showing the bases and rates used by the various State banking departments in assessing charges, together with other data. Your Office was furnished with a copy of the Board schedule, together with a schedule showing the cost to State banks of their examinations, in three representative size categories. In a reply to your Office's letter, the question of "equities", to which you refer, was discussed in some detail, on the basis of general principles as well as the factual information then available.

It appears to the Board that a supportable judgment as to the desirability of any legislation of the kind you propose, and appropriate provisions of such legislation, necessarily must be based on reasonably current factual information regarding the situation to which the proposed legislation relates. It is not possible to decide whether banks in one category (for example, national banks) are unjustly burdened unless their actual examination-expense burdens can

The Honorable James J. Saxon -4-

be compared with those of banks in other categories with which they are in competition. Likewise, the appropriate dollar amount, if any, of the Federal Government's contribution to the cost of national bank examinations cannot be ascertained except on the basis of comparable current data regarding the cost of supervisory examinations to the several classes of banks concerned. If you wish, the Board will cooperate in obtaining, compiling, and analyzing relevant up-to-date information.

Needless to say, Congress must decide ultimately whether the costs of national bank examinations should be borne by those banks or defrayed otherwise, in whole or part. If Congress should decide that the latter alternative is in the public interest, further questions would arise, not only as to amount but also as to whether appropriated funds (rather than Federal Reserve funds) should be utilized. The responsibility of the agencies concerned is to furnish to Congress adequate information on which to base its decisions as well as recommendations and reasoned arguments as to appropriate legislative action.

In your recent communications to the Board, you have emphasized one of the several considerations that relate significantly to the subject of the appropriate distribution of the expense of bank examinations--the fact that national banks bear the expense of examination by Federal authorities, whereas State banks do not. By mentioning only this circumstance, the impression could be created that an obvious inequity exists.

However, this is only one of a number of relevant circumstances. Some of these were outlined in earlier correspondence between the Board and your Office. It is perhaps sufficient to point out, by way of illustration, that, when this subject was studied in 1955 and 1956, many State banks were paying much larger examination fees to State supervisory authorities than were paid to the Comptroller of the Currency by national banks of the same size. From the viewpoint of State banks in that situation, whatever inequity existed was against them, not in their favor, and it would be exaggerated, rather than ameliorated, by enactment of legislation under which the Federal Government would pay a part of the cost of national bank examinations, thereby reducing the examination fees paid by national banks and increasing their advantage, in this respect, over their State bank competitors.

This example is mentioned, not to suggest that legislation on this subject is unjustified, but only to demonstrate that the question of relative equities in this matter is complex, and that erroneous impressions may be created by emphasizing one fact to the exclusion of others that are equally significant.

The Honorable James J. Saxon -5-

The Board of Governors feels compelled to refer to certain statements in your recent letters. These letters speak of "long existing and obvious discrimination against national member banks" and "harsh discriminatory treatment of national member banks" by the Board. The Board is unable to understand the basis or reason for such statements. It would be difficult to conceive of any reason why the Board would discriminate against national banks, which you describe as "the backbone of the Federal Reserve System." To the Board's knowledge, even the most vigorous critics of the Federal Reserve System have never made such an accusation.

The intricate Federal supervisory system, consisting of three coordinate agencies, requires a high degree of comity and cooperation for its successful operation. Fortunately, the history of Federal bank supervision has been characterized, with rare exceptions, by an understanding of this situation and by an atmosphere of patience, tolerance, candor, and willingness to work harmoniously to solve the difficult problems that constantly arise. The Board of Governors hopes that the agencies concerned will continue to approach their problems in the spirit of mutual helpfulness that has marked their relationships for many years.

Enclosed with your letter of March 16 was a draft of a bill to authorize the Federal Reserve System to pay to your Office up to 25 per cent of the expense of national bank examinations. As previously indicated, the Board of Governors believes that the substantive terms of any legislative proposal should be worked out on the basis of current information. It is also mentioned that the draft bill may require revisions of terminology and coordination with related provisions of Federal law, such as other provisions of section 5240 of the Revised Statutes and section 26-102 of the Code of Laws of the District of Columbia.

Sincerely yours,

(Signed) Bill M.

Wm. McC. Martin, Jr.