Minutes for April 10, 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 Tuesday, April 10, 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. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Chase, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Conkling, Assistant Director, Division of Bank Operations
Mr. Kiley, Assistant Director, Division of Bank Operations
Mr. Goodman, Assistant Director, Division of Examinations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Thompson, Assistant Director, Division of Examinations
Mr. Grobel, Special Assistant, Division of Examinations
Mr. Guth, Review Examiner, Division of Examinations

Application of First National City Bank (Item No. 1). First National City Bank, New York, had applied for permission to establish a branch in Geneva, Switzerland. In a memorandum dated April 5, 1962, which had been distributed to the Board, the Division of Examinations recommended favorable action; such action also had been recommended by the Comptroller of the Currency in a letter dated March 19, 1962.

Discussion of the matter related to two aspects of the case. The first question, raised by Governor Mitchell, related to the indication that the branch would accept numbered accounts, in accordance with the practice followed by competitive institutions in the Swiss banking market. In this connection, Mr. Goodman referred to a published article by a graduate student which indicated that complete data as to the identity of the owner of a numbered account was on file with the management of the bank at all times. In order that the Board's records might be complete, it was suggested that Mr. Goodman get in touch with First National City Bank to determine whether the information contained in the article to which Mr. Goodman had referred was substantially correct.

The second question, also raised by Governor Mitchell, related to the understanding of the New York Reserve Bank that Swiss banking law would prohibit any agency of the United States Government from examining the books and records of a branch of an American bank located in Switzerland. It was noted that if the application under consideration was approved by the Board of Governors, the question of examination of the proposed branch would fall within the purview of the Comptroller of the Currency. As indicated in a memorandum included in the file of this case, the Deputy Comptroller of the Currency had informed Mr. Goodman that the Comptroller's Office would have no objection to the establishment of the proposed branch notwithstanding any provisions of Swiss law that would prohibit that Office

from conducting examinations. In the circumstances, it was concluded that no further question need be raised on that score.

Thereupon, unanimous approval was given to a letter to First National City Bank approving the establishment of the proposed branch in Geneva. A copy of the letter is attached as Item No. 1.

Mr. Goodman then withdrew from the meeting.

Report on competitive factors (Lynchburg-Big Island, Virginia). There had been distributed a draft of report to the Comptroller of the Currency on the competitive factors involved in the proposed merger of Bank of Bedford Inc., Big Island, Virginia, into The Peoples National Bank & Trust Company of Lynchburg, Lynchburg, Virginia.

The report, in which the conclusion read as follows, was approved unanimously for transmittal to the Comptroller:

> There is no evidence of strong competition between the two banks. The proposed merger should have the favorable effect of increasing competition in Bedford by converting the operation of the branch of the smaller bank to a branch of the larger Peoples National Bank.

Draft bill to amend section 5155 of Revised Statutes (Item No. 2). There had been distributed a draft of reply to a request from the Bureau of the Budget for the Board's views on a draft bill proposed by the Treasury Department "to amend section 5155 of the Revised Statutes relating to bank branches which may be retained upon conversion or consolidation or merger."

A clarifying change suggested by Mr. Shay having been agreed upon, unanimous approval was given to a letter to the Budget Bureau in the form attached as Item No. 2.

Mr. Shay then withdrew from the meeting.

Bank of American Samoa (Item No. 3). At its meeting on February 12, 1962, the Board discussed the eligibility for membership in the Federal Reserve System of the Bank of American Samoa, located in Pago Pago, American Samoa. It was noted that the group of seven islands comprising American Samoa constituted a dependency of the United States located in the South Pacific. The administration of American Samoa resided in the Secretary of the Interior, and the Bank of American Samoa was a corporate agency or instrumentality of the Samoan Government. It had been managed for a number of years under a contract with Wells Fargo Bank, San Francisco, California, but the contracting bank reportedly was anxious to terminate the arrangement.

In view of certain questions regarding the membership inquiry, which had been forwarded to the Board through the Federal Reserve Bank of San Francisco, the Division of Examinations was requested at the February 12 meeting to obtain further information from the Department of the Interior, and a report on discussion with a representative of the Department was set forth in a memorandum from Mr. Solomon dated March 30, 1962, which had now been distributed to the Board.

In commenting on the matter, Mr. Solomon said it was his impression that it was doubtful whether the Bank of American Samoa would be interested in Federal Reserve membership if such membership did not provide deposit insurance, and it appeared that the bank would not qualify as a "State bank" under the Federal Deposit Insurance Act. It seemed to him important that this point be specified in replying to the San Francisco Reserve Bank.

Mr. Solomon also expressed doubt whether, if the Bank of American Samoa were located within a State of the Union, its condition would make it acceptable for membership in the Federal Reserve System. It seemed desirable to him that the Board make clear in its letter that the fact that the Bank of American Samoa would legally qualify for membership in the Federal Reserve System did not necessarily mean that it would be accepted for membership.

There followed discussion, at the instance of Governor King, regarding whether there seemed to be any assistance that the Federal Reserve might render, in the existing circumstances, with a view toward assuring the availability of an adequate banking facility in the American dependency. It appeared, however, that the best prospect would be a purchase of the Bank of American Samoa by the Bank of Hawaii, which was understood to have expressed some interest. It was noted that the situation apparently was well understood by the Department of the Interior.

At the conclusion of the discussion, unanimous approval was given to the letter to the Federal Reserve Bank of San Francisco of which a copy is attached as Item No. 3.

United Security Account Plan. There had been distributed a memorandum from the Legal Division dated April 4, 1962, reporting the results of a special examination of Citizens Bank and Trust Company, Park Ridge, Illinois, by the Federal Reserve Bank of Chicago for the purpose of obtaining information regarding the actual manner of operation of the bank's United Security Account Plan, particularly in the light of the Board's Regulation Q, Payment of Interest on Deposits, as it had been amended effective January 15, 1962, to revise the definition of savings deposits. From the examination, it developed that the bank had entered into contracts with depositors which, if carried out in accordance with one of the alternatives offered, namely, an instruction to the bank to transfer funds from savings deposits to pay outstanding "loans" created by the bank's payment of checks drawn by the savings depositor, would result in violations of section 19 of the Federal Reserve Act and of Regulation Q. However, because of operating difficulties, including a breakdown of the bank's electronic accounting machinery, no withdrawals from savings accounts pursuant to such instructions had been made since January 15, 1962. It was understood that the Reserve Bank intended to make a further investigation toward the end of April.

It was the view of the Legal Division that it would be proper for the Board again to inform Citizens Bank that its contracts with customers, if carried out according to the aforementioned alternative, would result in violations of section 19 and of Regulation Q. A draft of letter to such effect was submitted with the memorandum.

After Messrs. Hexter and Hooff had reviewed the situation and stated reasons why in their opinion the available information concerning the operation of the United Security Account Plan warranted sending to Citizens Bank at this time a letter along the lines that had been drafted, Governor Robertson asked several questions regarding the possibility of an alternative approach to the problem and indicated that he would like to have action on the proposed letter deferred in order that he might study the situation further and make a recommendation.

Governor Mitchell also made certain comments, which were to the effect that he felt the plan would prove to be unprofitable and that it therefore might be discontinued voluntarily by the bank in due course. He suggested that for the moment the position might simply be taken, in response to inquiries, that the operation of the plan was regarded as being in violation of section 19 and Regulation Q.

At the conclusion of the discussion it was agreed, pursuant to Governor Robertson's request, to defer action on the matter.

Messrs. Chase and Hooff then withdrew from the meeting and Mr. O'Connell, Assistant General Counsel, entered the room.

Envelope drafts (Item No. 4). There had been distributed to the Board copies of a memorandum from Governor Balderston dated April 6, 1962, recommending that a letter be sent to the President of each Federal Reserve Bank indicating the Board's concern as to the spreading use of envelope drafts not susceptible to high-speed handling and raising the question whether the imposition of a handling charge for such items would be desirable as a means of deterring this development. Submitted with the memorandum was a draft of letter to such effect.

The memorandum noted that in February 1960 the Presidents' Conference Subcommittee on Collections and Subcommittee of Counsel on Collections submitted a joint report containing a recommendation, subsequently approved by the Conference, that the Reserve Banks continue to handle envelope drafts and other "headache" checks as cash items, but that Regulation J, Check Clearing and Collection, and the check collection operating circulars of the Reserve Banks be revised to make it clear that the Banks had authority to prescribe conditions for such handling, including separate sorts and different closing times. Regulation J was so amended effective August 10, 1960. In August 1961 the Subcommittee on Collections was asked to give further consideration to the matter, and in a report dated January 26, 1962, that Subcommittee and the Subcommittee of Counsel on Collections reaffirmed their previous

position that it would not be desirable at this time either (1) to require that headache checks be handled as noncash items, or (2) to impose handling charges on such items.

In comments supplementing his memorandum, Governor Balderston said his thought was not to override the judgment of the Subcommittees, but rather, after paying appropriate credit to their work, to ask the Presidents to keep the Board informed of any changes that might indicate a growth of the use of envelope drafts. He thought it was probably correct, as the Subcommittees had concluded, that the problem was not serious enough at this moment to require action. However, decisions on the part of only a few large companies could set in motion a snowballing operation that might soon become serious. His suggestion, therefore, was that the Board stay so closely on top of the problem, through the Presidents, that action could be taken promptly in the event of signs of accelerated growth. He added that the proposed letter to the Reserve Banks was an outgrowth of conversations he had had with Messrs. Farrell and Hackley, Associates on the Subcommittee on Collections and the Subcommittee of Counsel on Collections, respectively.

Turning more specifically to the proposed letter, Governor Balderston indicated that upon reconsideration he would suggest the deletion of a portion of one sentence that would express a tentative view that the only effective step in dealing with the problem might be

to continue to handle headache items as cash items but to impose a full cost-of-handling charge on items not susceptible to high-speed processing. This would leave the Board more in the posture of calling attention to the problem and requesting the views of the Presidents.

After discussion, it was the consensus that the deletion suggested by Governor Balderston would be appropriate. Accordingly, unanimous approval was given to a letter in the form attached as Item No. 4.

Messrs. Conkling and Kiley then withdrew from the meeting.

Applications of General Bancshares Corporation. At its meeting on February 27, 1962, the Board gave consideration to applications by General Bancshares Corporation, St. Louis, Missouri, for approval of the acquisition of stock of Commercial Bank of St. Louis County, Olivette, Missouri, and Lindbergh Bank, Hazelwood, Missouri. Action on the applications was deferred, however, pending the development of certain additional data. Such information was submitted by the Division of Examinations under date of March 30, 1962. The Division continued its recommendation that both applications be approved.

At the Board's request, Mr. Thompson commented on the additional data that had been developed, his comments being based substantially on the memorandum and supplemental memorandum distributed under date of March 30.

Mr. Solomon expressed agreement with Mr. Thompson's analysis. He added that, as Mr. Thompson had indicated, the holding company and its management did not appear to be of the highest quality. On the other hand, the Division of Examinations did not regard the company's position and management as unsatisfactory, at least to such an extent as to justify disapproval of the current applications on that basis.

There followed a general discussion during which a number of questions were raised regarding the circumstances surrounding the applications.

One of these questions related to whether it appeared that the holding company's cash outflow requirements would necessitate heavier dividends from its subsidiary banks to such extent as to be seriously detrimental to those banks. The staff comments were to the effect that the holding company appeared to be relatively close to a balanced position in terms of cash inflow and outflow. It did not appear that the anticipated outflow requirements would necessitate substantially heavier dividends from the subsidiary banks or that such additional dividends as might be involved would have an unduly adverse effect on the subsidiary banks. It was noted that although five of the eight banks were regarded as deficient in terms of capital under the Board formula, in no case was the deficiency serious.

Question was raised, by Governor Mitchell, regarding the securities portfolios of the subsidiary banks. At the time of 1961 examinations the aggregate depreciation amounted to $5,930,000, of which approximately $4,000,000 was attributable to holdings of housing authority bonds. Further, 24 per cent of the securities had maturities over 20 years while another 14 per cent had maturities from 10 to 20 years. The staff comments indicated that this situation was traceable to purchases made several years ago, when the banks apparently had been oversold on long-term housing authority bonds. The securities were of good credit rating, but depreciation had been incurred as the result of changes in interest rates. The comment of Governor Mitchell was to the effect that he considered this situation a reflection on the competence of the management of the holding company.

Attention was called to a letter dated October 20, 1961, from Mr. Harry Guthmann, Professor of Finance at Northwestern University, who stated that the proxy material distributed to shareholders of General Bancshares in connection with the proposed bank acquisitions had been brought to his attention by certain shareholders. He suggested that two matters seemed to merit special consideration: (1) the propriety of officers and directors profiting by the formation of new banks and the subsequent sale of those banks to a holding company served by such officers and directors; and (2) the propriety of fixing a price for the shares of the two banks of about 40 per cent and 20 per cent, respectively, over book value, even though one of those banks had not

yet reached the break-even point and the other showed only nominal earnings. He suggested that the Board of Governors, representing the public interest, was the proper body to give the searching attention required in such a matter.

The question raised in connection with Professor Guthmann's letter involved the extent of responsibility of the Board of Governors when disclosure had been made to shareholders. Comments by members of the staff were in terms that while the regulations of the Securities and Exchange Commission required disclosure, they did not go beyond that point and prohibit self-dealing if it was fully disclosed. Further, the National Bank Act recognized the right of directors of national banks to deal with such banks. As to the premium offered in these two cases, it was pointed out that the funds to establish the two banks proposed to be acquired had been invested by persons who had received no earnings from them up to this point. In this sense, therefore, the premiums were not as large as might at first appear. It was also noted that under the Bank Holding Company Act the Board's sole function in a case of this kind was to approve or deny a proposed acquisition of stock. This raised the question whether a decision to deny would be too harsh a sanction. As to the question whether the public interest would be served by permitting the two banks to be acquired by the holding company, it was pointed out that they were now in effect being operated under the same management as the holding company.

On the foregoing points, Governor Mitchell made the comment that more rigid standards of conduct and of judgment might be expected from persons in the banking business than in certain other lines of endeavor, and that the legality of transactions might still leave doubt as to their desirability from the standpoint of the public interest. As to the management that would be available to the two banks proposed to be acquired, he felt that the record of the holding company did not reflect good management. He considered it doubtful, therefore, whether the public interest would be served by bringing the two banks within the holding company group.

With regard to the premium being offered, Governor Robertson noted that in no such case was a new bank expected to reach the point of profitability for some period of time. Hence, he doubted the validity of an argument justifying the premium in these cases on the basis that those who invested initially in the two banks had received no earnings on their funds. Further, he doubted whether there was sufficient justification for permitting the holding company, in view of the quality of management as judged by the record, to acquire the two banks from the individuals concerned through the medium of borrowed money. It was not clear to him what public benefits could be shown.

Governor King suggested that it was worthy of consideration to note that although the two small banks were now in effect under the same management as the holding company, the percentages of ownership

interest in those banks and in the holding company were not the same. Where management was the same, he thought it desirable that ownership be proportionate, for otherwise decisions might be made favoring the institution in which those making the decisions had the greater direct interest. He further suggested that the Board could not hope to check on all of the operations of a bank holding company. It could only undertake to assure that shareholders were afforded certain basic rights, including the right of disclosure.

Another question that was raised had to do with the philosophy that should be applied in situations where the controlling stockholders of a bank or bank holding company were also the controlling stockholders of a bank sought to be acquired. In discussion of this point, it was noted that an examination of competitive factors would reveal, where such a situation existed, that the community of ownership had caused such competition as previously existed to be lessened. Governor Robertson pointed out, however, that the adoption of an attitude that such circumstances made a proposed merger or acquisition more eligible for approval would constitute an invitation to a bank or bank holding company to arrange for its representatives to acquire control of another banking institution, with the thought that the prospect of approval of a subsequent application by the bank or bank holding company to acquire such institution would thereby be enhanced.

Question was raised as to what would be gained by rejecting the current applications, and Governor Mitchell suggested that approval

would constitute an endorsement of the applicant holding company whereas denial would indicate that in the view of the Board the status quo would not be substantially improved by the proposed acquisitions. Mr. O'Connell suggested that denial on the basis implied in Governor Mitchell's comment would presume that the Board was prepared to issue a statement wherein management deficiencies would be cited as the primary basis for the adverse action. This was because the competitive factors did not appear to be such as to support a decision to deny. This was not to suggest that an adverse decision could not be defended, but a showing of substantial evidence would entail a discussion of matters pertaining to management.

The members of the Board then expressed their views, beginning with Governor Mills, who stated that he would favor approval of the applications on the grounds submitted by the Division of Examinations. His principal concern was that the effect of the transactions would be to impose a strain on the subsidiary banks to produce earnings for the holding company to service its debt and dividend requirements, but he did not consider that an obstacle to approval. He was impressed by the reasoning of Governor King that more harm might be done by preventing the transfer of these properties to the holding company than by approving. Also, the argument could be made that Mr. Preston Estep, Chairman of the Board of General Bancshares, who was the principal stockholder of the two small banks proposed to

be acquired, had used his own resources to carry them through infancy into self-sufficiency. They had become properties that were salable and eligible for inclusion as holding company subsidiary banks. As to the banks now in the holding company group, they were all insured and subject to examination by the Federal Deposit Insurance Corporation. The supposition would be, therefore, that their assets and standing were of such quality as to afford proper protection to their depositors. They might not rank with the best of the banks with which the Board was familiar, but at the same time they were self-sufficient and banks of reasonable quality. The same generalization would seem to apply to the holding company as such. There were degrees in the quality of holding companies, and this one did not seem unsatisfactory, although below top quality. He could not conclude that the holding company was an improper trustee and guardian of the interests of its shareholders.

Governor Robertson said that he considered this a marginal case. He could see why others might vote to approve the applications, but he could not vote to approve. Notwithstanding the fact that there had been disclosure of the details of the proposed transactions to the holding company's shareholders, self-dealing was involved. Also, there was the question of the quality of the holding company itself. And the holding company was taking over financial obligations of an official who knew that the acquisition of the two small banks would place an additional financial burden on the holding company. Since he

(Governor Robertson) could not discern public benefits that would flow from the proposed transactions, he concluded that approval of this proposal to relieve the official's financial burden would not be warranted.

Governor Shepardson said it did not seem to him that any particular public benefit from these acquisitions had been established. From the discussion of these applications, he felt there was too much question about the existence of such a benefit to justify approval.

Governor King said that he did not think anyone could be too enthusiastic about the situation. Nevertheless, he felt that approval of the applications was warranted.

Governor Mitchell stated that he would disapprove, substantially for the reasons Governors Shepardson and Robertson had mentioned. As he saw it, approval would constitute an indication of endorsement of the holding company by the Board. It would enable the holding company to get a little larger, to accumulate a little more prestige. In his opinion, the management was not good, and growth of the holding company system should not be encouraged until management improved. Further, he did not like the relationship existing between the holding company and the ownership of the banks sought to be acquired.

Governor Balderston said he would approve, though reluctantly, because he was not sure there was a clear enough case for disapproval to make such action supportable.

Chairman Martin likewise indicated that he would approve, with some reluctance. His principal reason was that denial might only produce stagnation, and he did not think that stagnation would be in the public interest.

Accordingly, the applications of General Bancshares Corporation were approved, Chairman Martin and Governors Balderston, Mills, and King voting to approve and Governors Robertson, Shepardson, and Mitchell voting to deny. It was understood that the Legal Division would prepare an order and statement reflecting this decision for the Board's consideration, and that a dissenting statement also would be prepared.

The meeting then adjourned.

Governor Shepardson noted today on behalf of the Board that application for retirement had been filed by Karl P. Wendt, Senior Federal Reserve Examiner, Division of Examinations, effective May 1, 1962.

Secretary

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

Item No. 1
4/10/62

April 11, 1962

First National City Bank,
399 Park Avenue,
New York 22, New York.

Gentlemen:

The Board of Governors of the Federal Reserve System authorizes First National City Bank, New York, New York, pursuant to the provisions of Section 25 of the Federal Reserve Act, to establish a branch in the City of Geneva, Switzerland; and to operate and maintain such branch subject to the provisions of such Section.

Unless the branch is actually established and opened for business on or before April 1, 1963, all rights granted hereby shall be deemed to have been abandoned and the authority hereby granted will automatically terminate on that date.

Please advise the Board of Governors, in writing, through the Federal Reserve Bank of New York, when the branch is opened for business, furnishing information as to the exact location of the branch.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 2
4/10/62

April 10, 1962

Mr. Phillip S. Hughes,
Assistant Director,
Legislative Reference,
Bureau of the Budget,
Washington 25, D. C.

Dear Mr. Hughes:

Your Legislative Referral Memorandum of April 3, 1962, asked for the Board's views on a draft bill, proposed by the Department of the Treasury, "To amend Section 5155 of the Revised Statutes relating to bank branches which may be retained upon conversion or consolidation or merger".

The draft bill would amend the law cited above to provide that in case of a merger, consolidation, or conversion where the continuing or acquiring bank would be a national bank, such bank could retain and operate any branches which it had in lawful operation immediately prior to the merger, consolidation, or conversion and could do so without securing anew, as is necessary under present law, the approval of the Comptroller of the Currency.

It appears that the objectives of the draft amendment are to authorize the retention of branches permissible under State law when established and to improve the administration of the Federal statute by eliminating the need for the second approval of branches, which serves no useful purpose. This change in the law was proposed also in the bill S. 1451 in the 85th Congress ("Financial Institutions Act of 1957"), as it passed the Senate.

While the draft bill concerns a matter outside its province, the Board believes that enactment of such a change in the law would be in the public interest.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 3
4/10/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 10, 1962.

Mr. E. H. Galvin, Vice President,
Federal Reserve Bank of San Francisco,
San Francisco 20, California.

Dear Mr. Galvin:

This refers to your letter of September 28, 1961, presenting the question of eligibility for membership in the Federal Reserve System of The Bank of American Samoa.

From information contained in a memorandum by your General Counsel, it is understood that The Bank of American Samoa, which conducts a general banking business, is organized under local law and located in an insular possession of the United States.

It is noted that no capital stock has been issued but the local government has made a capital investment which is designated "capital stock" in the bank's annual report. Although this account technically is not capital stock, it would appear to serve the same purpose for membership in the System.

The fact that The Bank of American Samoa is not a private corporation, but is a corporate agency or instrumentality of the Samoan Government, would not disqualify the bank for membership. Also, the manner of selecting directors and officers, while not usual to commercial banks and trust companies, would not render the bank ineligible for membership.

Accordingly, the Board has concluded that, as a legal matter, The Bank of American Samoa might qualify for membership in the Federal Reserve System under the twelfth paragraph of section 19 of the Federal Reserve Act. However, there are substantial questions of policy as to whether or not it would be in the public interest for a bank such as The Bank of American Samoa to become a member of the Federal Reserve System, and in the event the bank applied for membership, careful consideration would have to be given to these basic questions of policy. In any event, membership would not confer deposit insurance upon the bank as it would not qualify as a "State bank" under the Federal Deposit Insurance Act.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 4
4/10/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 10, 1962.

Dear Sir:

The Board has noted that envolope drafts and other "headache items" not susceptible to high-speed handling have been the subject of discussions during the last two years by the Conference of Presidents and subcommittees thereof, and it understands from the committee reports that the Reserve Banks as a group

(1) Are reluctant to handle these items as noncash collections because of the expense involved.

(2) Feel that imposition of a handling charge would raise questions of law and of bank relations, including the question whether such charges would be discriminatory and whether the Board should fix charges which may be imposed by member banks for clearing or collecting checks generally.

(3) Are inclined to await further developments before imposing any kind of special requirements on "headache items," and, if such a step became necessary, would place chief reliance upon the 1960 amendment to Regulation J under which separate sorts and different closing times could be required for items not susceptible to high-speed handling.

The Board appreciates the thorough consideration that has been given to this problem by the Subcommittee on Collections and the Subcommittee of Counsel on Collections, and recognizes that through System efforts some progress has been made toward minimizing the problem in certain areas. Nevertheless, it is concerned about the success on an over-all basis of the present program and is concerned that the use of envelope drafts will grow into a much more serious problem unless firm steps are soon taken by the System. There is some feeling on the part of the Board that the special requirements now provided for in Regulation J may not be enough to overbalance the advantages of envelope drafts to the users thereof.

Inasmuch as this is a problem on which judgments may differ, and believing that varying opinions may be helpful, the Board would like

to have the views of your Bank as to

(1) Whether "headache items" are now a significant problem in your District, whether the problem shows signs of increasing or diminishing, and whether there is a need to take prompt action on a System basis before the problem becomes uncontrollable.

(2) Whether the imposition of separate sorts and different closing times would be effective in deterring the use of envelope drafts and certain other "headache items."

(3) Whether it would be desirable (or undesirable) for the System to impose charges for handling such items, and what might be appropriate rates for such charges. Since envelope drafts generally impose additional postage costs on the Reserve Banks, consideration might be given to whether the charge for handling envelope drafts should be higher than the charge for handling other "headache items."

After there has been time to consider the replies to this letter, which is being sent to the Presidents of all Federal Reserve Banks, the Board will probably wish to discuss the matter with the Presidents jointly.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS