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Minutes for June 26, 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, June 26, 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 1/
Mr. Shepardson
Mr. King
Mr. Mitchell

Mr. Sherman, Secretary
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Solomon, Director, Division of Examinations
Mr. Johnson, Director, Division of Personnel Administration
Mr. Hexter, Assistant General Counsel
Mr. Conkling, Assistant Director, Division of Bank Operations
Mr. Masters, Associate Director, Division of Examinations
Mr. Sprecher, Assistant Director, Division of Personnel Administration
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Potter, Senior Attorney, Legal Division
Mr. Young, Senior Attorney, Legal Division
Mr. Wood, Personnel Assistant, Division of Personnel Administration

Grand Haven-Spring Lake consolidation. Governor Mills stated that he had just had a telephone call from Mr. Slay, Michigan State Superintendent of Banks, regarding the order issued by the Board yesterday approving the application of The Peoples Bank and Trust Company, Grand Haven, Michigan, to consolidate with The Spring Lake State Bank, Spring Lake, Michigan. Superintendent Slay had called about the provision in

1/ Withdrew from meeting at point indicated in minutes.

the Board's order that the consolidation should not be consummated sooner than seven calendar days after the date of the order or later than three months after that date. For reasons of convenience, the banks involved would like to consolidate on July 2, 1962, which would be the seventh day after the Board's order, and Superintendent Slay asked if the Board would be willing to waive its seven-day waiting period to allow them to do so.

Mr. Hackley observed that the seven-day waiting period was agreed upon by the Board after consultation with the Department of Justice, and was incorporated in the Board's published Rules of Procedure. While he had sympathy with the desire to suit the convenience of the consolidating banks, Mr. Hackley hesitated, as a matter of principle, to make an exception to the Board's published rule.

The ensuing discussion brought out the fact that the Board's order provided that the consolidation should not be consummated "sooner than seven calendar days" after the date of the order, and Mr. Hexter stated that this should be interpreted as allowing the transaction to take place on the seventh day, which in the case of the Grand Haven order would be July 2, 1962, the date on which Superintendent Slay had indicated the banks were planning.

Governor Robertson expressed the opinion that no deviation should be made from the provision of the Board's order under discussion, but if the rule could properly be construed as allowing consummation of

the Grand Haven consolidation on the seventh day, it would be appropriate so to inform Superintendent Slay.

Other members of the Board agreed that Superintendent Slay should be informed by telephone that the Board's construction of its order approving the Grand Haven-Spring Lake consolidation would permit consummation of the transaction effective July 2, 1962.

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on June 25, 1962, of the rates on discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

Application of Drovers National Bank (Item No. 1). A draft of letter, which had been circulated, approving the application for fiduciary powers of The Drovers National Bank of Chicago, Chicago, Illinois, was approved unanimously. A copy of the letter is attached as Item No. 1.

Trust powers of national banks (Item No. 2). There had been distributed a memorandum dated June 25, 1962, from the Legal Division, in connection with a request from the Bureau of the Budget for the views of the Board on a Treasury draft bill that would transfer from the Board to the Comptroller of the Currency authority to grant to national banks the right to act in fiduciary capacities, and to regulate the exercise of fiduciary powers by national banks, including the operation

of common trust funds. This was a revision of a bill proposed by the Treasury in 1959, although the 1959 proposal did not contemplate the transfer of common trust fund regulation. The Board, in its report of April 24, 1959, on the earlier bill, stated that it was preferable that regulatory authority over all aspects of trust activities of national banks be vested in the Comptroller of the Currency, and urged that the bill be amended to include the transfer of the Board's authority to regulate common trust fund operation. The present draft bill included all of the Board's 1959 recommendations. Attached to the Legal Division's memorandum was a draft of letter stating that the Board favored the proposed bill.

Governor Robertson asked if the Board had received notice of a suggestion for another bill that would transfer the currency function from the Comptroller of the Currency to the Board. Staff responses indicated that it was understood that such a suggestion had been made, although the Board had heard of it only indirectly.

Governor Balderston noted the coincidence that the report on the Treasury draft bill came before the Board at the same meeting when a preliminary discussion of the operation of common trust funds was scheduled (later on the agenda).

Governor Mills said that he too had noted that coincidence, and if there was any possibility that the draft bill would pass the current session of Congress, any actions taken by the Board on the pending

questions regarding common trust funds would be in effect making prejudgments that might not be consistent with the thinking of the Comptroller of the Currency. If that sort of situation should develop, Governor Mills was of the opinion that the Board should withhold action in order to allow the Comptroller of the Currency to make his own decisions.

After further discussion, the letter to the Bureau of the Budget was approved unanimously. A copy is attached as Item No. 2.

Continental Bank and Trust Company (Item No. 3). There had been distributed a memorandum dated June 25, 1962, from the Legal Division, regarding a request by The Continental Bank and Trust Company, Salt Lake City, Utah, that the forthcoming show cause hearing be held in a building other than the Federal Reserve Branch building at Salt Lake City. Continental Bank had requested that the hearing scheduled for July 23, 1962, be open to the public, and that the place of the hearing be changed from the offices of the Salt Lake City Branch of the Federal Reserve Bank of San Francisco to "some other public building in Salt Lake City on the ground that the nature of the said office building with armed guards and barred doors is such as to deter the members of the public from attending the hearing should they so desire."

On June 8, 1962, the Board had ordered that the hearing be public, but with respect to the request for change of location, Board Counsel were given until June 18, 1962, to submit comments. On June 14,

1962, Board Counsel submitted a statement in opposition to the request and a copy of the statement was served on Counsel for Continental Bank.

Inquiries that had been made indicated that access to the Salt Lake City Branch building would not be such as would unreasonably deter or inhibit public attendance at the hearing. Especially, the "armed guard" in the front door lobby served an informational function primarily rather than a protective function. Also, it was felt by Board Counsel that a sign in the public lobby of the branch building indicating in what room the hearing would be held would dispel any hesitation that might be felt by persons desiring to attend the hearing. Attached to the memorandum was a draft of letter to Counsel for Continental denying the request that the hearing be held in a different place, and citing the provisions of the Board's Rules of Practice for Formal Hearings that seemed to support that view. It was also pointed out that the Board's Hearing Examiner had the right to change the location of the hearing, regardless of the decision that the Board might now make.

After discussion, the letter to Counsel for Continental Bank was approved, Governor Robertson not participating. A copy is attached as Item No. 3.

Mr. Potter then withdrew.

Policy on employee-management cooperation (Item No. 4). There had been distributed a memorandum dated June 25, 1962, from the Division of Personnel Administration in connection with an Executive Order issued

by the President on January 17, 1962, directing that certain policies should govern officers and agencies of the Executive Branch in dealings with Federal employees and organizations representing them. Each agency was to issue policies, rules, and regulations for the implementation of the order not later than July 1, 1962. On the assumption that the Board's personnel program should include a policy with respect to recognition of employee organizations, the Division of Personnel Administration had prepared and attached to its memorandum a proposed statement of policy on employee-management cooperation.

The memorandum pointed out that many facets of the employee-management cooperation program were still in the discussion stage, and the general approach of Government agencies that had not had previous experience with employee organizations had been to proceed slowly. Therefore, the proposed statement covered only the framework of the program, with the expectation that specific procedures could be provided at a later date without revising the basic policy. The Employees' Committee, the one employee organization already in operation, had reviewed the proposed policy and had no suggestions to make.

During discussion it was observed that a question might be raised as to whether the Board was subject to the Executive Order. However, without raising that issue, the environment in which the Board operated pointed to the desirability that the Board adopt an employee-management cooperation policy essentially paralleling that of other Government agencies.

It was suggested that the second paragraph of the statement under the subheading "Procedures" be deleted, and agreement was expressed with that suggestion. With that deletion, the statement was approved unanimously. A copy of the statement in the form distributed to all members of the Board's staff is attached as Item No. 4.

Messrs. Johnson, Sprecher, Young, and Wood then withdrew.

Common trust funds. There had been distributed a memorandum dated May 15, 1962, from Mr. Masters, relating to questions arising from the bona fide fiduciary purpose provisions of Regulation F, Trust Powers of National Banks. The memorandum discussed in extensive detail the history of the Board's regulation of common trust funds, specific plans offered by particular institutions that seemed to depart from the original purpose of common trust funds, and developments leading to the basic question with which the Board was now confronted, namely, whether the bona fide fiduciary purpose provisions of the regulation should be strengthened in order to restrict the use of such funds within the true trust concept, or whether to relax the provisions of the regulation so as to allow wider use of common trust funds. One of the principal apprehensions as to following the latter course, aside from abandonment or weakening of the true trust concept, was that some banks would in effect be offering investment management services similar to those offered by mutual investment funds. The memorandum analyzed various proposals that had been made, some for enforcement of the true trust concept, and others for liberalization of that concept. The conclusion

of the memorandum was a recommendation that the all-out liberalizing approach be discarded as inconsistent with sound banking practice and incompatible with the traditions and principles of the American system of trust business. The recommendation would also discard all the alternatives directed toward enforcing more strictly the original conceptual purpose and apparent intent of the bona fide fiduciary purpose provisions, on the premise that the concept, as it had been interpreted and attempted to be applied, was so abstruse as to be virtually unenforceable except by measures so extreme as to impose unwarranted burdens on trust business. The recommendation would abandon the bona fide fiduciary purpose test for the additional reason that it was already too restrictive. This view was based on recognition of the desirability in the public interest and the propriety (legally, ethically, and practically) of trust institutions providing investment management services - with or without accompanying fiduciary purpose of a more specific nature - for the rapidly increasing number of individuals requiring such services in connection with their estate accumulation plans. Such services seemed wholly consistent with the proper functions of trust institutions, and the appropriate furnishing of such services by trust institutions would require the use of common trust funds. Though not a wholly satisfactory test, such services might be reasonably differentiated from more direct collective investment of funds (mutual fund investment) by (1) necessity for use of the trust form in establishing such fiduciary

relationships, (2) the discretion of the trust institution in authorizing common trust fund investment of any such trust, and (3) a curb on common trust fund advertising and publicity.

The recommendation would impose specific prohibitions on the advertising and publicity of common trust funds designed to prohibit their use as a means to attract trust business. Removal of the present regulatory language imposing qualifications on fiduciary purpose and use ("strictly," "true," and "bona fide") would broaden the use of common trust funds by and within a trust institution to serve the investment needs of trusts normally seeking the fiduciary services (including investment management services) it had to offer. Curtailment of publicizing common trust funds would be relied upon to control misuse of such funds as investment trusts for other than fiduciary purposes, that is, to keep common trust funds from being offered to the public as an investment entity whether in competition with mutual funds or otherwise, and to guard against creating in the public mind false impressions of common trust fund purpose and use. Mr. Masters' memorandum concluded by suggesting amendments to Regulation F intended to implement his recommendations.

In beginning the discussion, which was intended to be preliminary and not to lead to action at today's meeting, Mr. Masters commented that the regulatory problem confronting the Board defied simple solution. It had been clear for some time that a regulatory provision as indefinite as

the present bona fide fiduciary purpose test was incompatible with effective supervision of common trust funds. In its present ambiguous form, the test was bewildering to trust business and virtually useless to supervisory enforcement. Abandonment of the principle of the true trust, however, could not only lead to abuses in which access to common trust funds would be allowed to investors for whom that vehicle had never been intended, but, conversely, could deny access to common trust funds to many trustors of the kind such funds had originally been intended to serve. The fundamental question, therefore, was choice of the wisest principles to underlie common trust fund utilization and effective methods to define and preserve the principles so determined. Unfortunately, no really acceptable method had been suggested from any source that gave promise of being effective in containing common trust funds solely within the restricted use originally intended without, at the same time, imposing arbitrary restrictions that would deny access to such funds by significant segments of trust business that appropriately might be commingled.

Mr. Masters noted that a key point of his recommendation was the imposition of specific restrictions on all forms of printed advertising and publicity regarding common trust funds; that restriction seemed to have the virtue of striking at the single feature of the use of common trust funds that gave them the appearance of mutual funds. In his view, the common trust fund, authorized solely as an internal facility for improved investment administration of trust business obtained in the course

of trust department conduct, was not a trust service to be popularized in and of itself.

An alternative to his recommendation, Mr. Masters continued, would be to authorize broader use of common trust funds to permit investment on behalf of any trust created for purposes of obtaining the normal services of a trust institution, not excluding services primarily, or perhaps solely, concerned with the investment management function. Developments in trust business and in public uses of trust institutions, especially since World War II, added strength to arguments for change in the original concept of limited use of common trust funds, suggesting a more liberal regulatory view and consideration of less rather than greater restriction on their scope. The adaptation of services to meet the developing investment management needs of the public in connection with its desires and plans to accumulate funds to serve long-range goals had been receiving increasing attention by trust institutions. Certainly from a theoretical approach, if trust form alone became the basic test or the sole test for entry to a common trust fund, the way would be open for those who wished to use such funds as an investment pool for the general public. While the opportunity to employ common trust funds as investment trusts for general public participation would be enhanced if the existing regulatory provisions were liberalized, the probabilities of such an alteration in the use of the common trust fund seemed unlikely. This was so, Mr. Masters believed, because of fundamental differences between common trust funds and mutual funds; he then commented on several of such differences.

In developing the recommendation for the Board's consideration, a mean between extremes had been sought. An attempt had been made to inject into the common trust funds regulations a little more liberalization and a little more restriction, both of which were believed needed. The aim had been both to broaden and to contain the common trust fund within the framework of conventional trust institution uses and, collaterally, to eliminate problems long associated with the true fiduciary purpose provisions. Where to draw the line was a difficult question; an even more perplexing one was how to defend the line drawn.

If the Board adopted the proposed liberalization, it might appear to condone a quasi-investment business for banks, and the risk would be heightened that some trust institutions might go to extremes with a common trust fund so liberated. It might be that the Board should not follow a course that could create such an atmosphere or contribute to such risks, remote as they might be under an effective ban on merchandising. If the Board was of the view that the recommended restrictions on advertising and publicity, together with other built-in control features, would not be sufficiently effective to restrain use of the common trust fund as an investment pool for wide-scale public use, perhaps it should consider a specific prohibition on common trust fund investment of revocable trusts or some category of them. In Mr. Masters' judgment, that would be an unhappy solution and one that would be much too harsh in view of the widespread and growing use of revocable trusts for purposes consistent

both with the needs of individuals creating such appointments and with traditional and appropriate trust institution activities.

Mr. Masters' comments, which he presented in substantially greater detail than they appear in these minutes, were read from a rough draft of a prepared statement.

In the ensuing discussion, members of the Board referred not only to the information in Mr. Masters' memorandum of May 15, 1962, regarding the bona fide fiduciary purpose test for participation in common trust funds, but also to the information in his memorandum of April 16, 1962, regarding proposals that had been made for increasing the dollar limitation on the amount of any one trust participating in a common trust fund. The Board discussed the proposals in the latter memorandum at its meeting of April 30, 1962.

The members of the Board then commented, beginning with Governor Mills, who stated that he believed he had some competence in the field of common trust fund operation, and spoke from experience. His opinions might be personal, but they were very strong, and they were completely antagonistic to what he considered a compromise of principle in the recommendation presented. This was the second of two proposals born of the ambitions of the trust people in the banking fraternity. The first was to lift the ceiling on the amount that could be invested in a common trust fund by any one participant; indeed, there were some trust people who would have removed the ceiling entirely. To do so, of course,

would completely invalidate the purity of the bona fide trust principle, which in Governor Mills' view should be retained. The theory of common trust funds - a desirable theory in his opinion - was the provision of a vehicle through which the individual of smaller means could have the advantage of trust services that were not otherwise available to him at reasonable cost because of the size of his estate. By commingling their funds a number of people of smaller means could share the advantages of trust supervision and custody of their affairs. The pressure for raising the ceiling had, of course, come from the larger trust companies, whose clientele was made up of people of far greater means than the country-wide average of common trust participants. If one looked at the size of the trusts in all common trust funds, it would be seen that an estate of $100,000 was a substantial one, and that permitting an estate of that size to enjoy the advantages of a common trust fund would serve the needs of the great majority of people who sought trust services for their convenience and safety. Raising the ceiling above $100,000 would in a sense deny the fact that a trust is a matter of highly personal consequence, an individual and precious sort of thing. The person who wants trust service wants the counsel of a trust officer who will give personal attention to his affairs. Raising the ceiling for participants in common trust funds would be tantamount to saying that a great many people are nonentities; their resources would be merged with those of a great many other people, and they would receive periodic reports of their

participation and income. Thus a trust company, foolishly in Governor Mills' opinion, would have lost the advantage of giving close attention to the trustor's or testator's wishes.

An especially important consideration at the present time, Governor Mills said, was that lifting the ceiling on common trust fund participation might expose a trust company to suits by participants in a trust for surcharges. If investments of trust funds fell substantially in value and there was an implication of inferior investment judgment on the part of the trustee, a suit by one participant for a surcharge on the trustee might bring on demands by all participants for surcharges. These were not nebulous possibilities: they were considerations that involved trust companies seriously in the late twenties and early thirties, and in many cases trust companies were justifiably surcharged.

In continuing, Governor Mills pointed out that the bulk of trust business was conducted by the trust departments of commercial banks. Thus, liberalization of the scope of trust activity would not only expose commercial bank capital to risk, but dissatisfaction among the participants in common trust funds might expose the entire operation of such funds to public criticism. As he understood it, the Securities and Exchange Commission opposed common trust fund liberalization on the sound grounds that it would lead banks into the securities business, and also that if common trust funds were used as an investment medium, banks would be involved in the mutual funds field. From recent reports emanating from the

investigations by the Securities and Exchange Commission it appeared that some mutual funds had become involved in suspect practices. To Governor Mills, it was not consistent with the regulatory responsibility of the Board to put banks in a position where they possibly could engage in a field in which, through ambitious salesmanship, they would be exposed to similar dangers.

As to the question of advertising common trust funds, Governor Mills observed that the entire proposal under consideration arose because the ambitious officers of certain banks stated quite frankly that their trust departments were being foreclosed from the opportunity to engage in the investment advisory field - that that field had been taken over by mutual funds and that banks should be permitted an opportunity for that business. To allow that opportunity, in Governor Mills' opinion, would contradict the reforms effected by legislation of the early thirties prohibiting banks from engaging in the securities business. Trust officers with whom Governor Mills had talked two months ago, when there was a slow decline in stock prices, had told him that they were receiving frequent questions from the beneficiaries of trusts about the value of their investments and the future status of their income. At the present time, when there had been a major slide in stock prices recently, those questions would be multiplied endlessly.

In conclusion, Governor Mills expressed the view that if the Board, merely because it had been pressured by ambitious business builders

among trust men, should allow a further incursion by banks into a field that did not belong to them, its conduct would be reprehensible.

Governor Robertson stated that he would like to present some considerations on the other side of the picture, without committing himself to a final view on that side. The proposals were very far afield from the original intent of the common trust fund, which was to make possible investment diversification for trusts that were too small to obtain diversification otherwise. Common trust funds had served that purpose admirably, exceeding the expectations of almost everyone who had advocated the concept. He believed that there was some basis for allowing considerably greater scope for common trust fund operations, but it seemed advisable to retain a top limit so that no single trust could jeopardize the funds of others if it had to withdraw from the fund. Therefore, Governor Robertson was of the view that it would be best to go back to the original proposal on the dollar limitation question, but to impose limits both in the dollar amount of any participating trust and in the percentage of the total fund that could be constituted by any single participant.

Liberalization of common trust fund operations would not be opening a new field to banks, in Governor Robertson's view. He thought that banks were already engaged in the kind of activity that was cited as potential; he knew of one bank that was acting as investment adviser to a mutual fund and being paid for it. He did not believe banks should

go so far as to sell securities to the public, but he could not quite see the justification for prohibiting a bank from advertising a service that it was authorized to perform. To him, therefore, the proposed prohibition on advertising had doubtful merit.

What concerned Governor Robertson most was the possible effect on public confidence in commercial banks if there were a great volume of funds in common trust funds and there should be such a development as the recent slide in securities prices. He had grave fears on that point, though he was not sure whether they were well-founded. His present inclination was to go along with the staff on a liberalization of the use of common trust funds, with advertising being allowed, but with limits on a participating trust both in dollar volume and in its percentage of the total fund, so that the withdrawal of any one trust would not jeopardize other estates in the fund.

Governor Robertson recalled the discussion earlier in this meeting of the proposal to transfer to the Comptroller of the Currency supervision of trust powers of national banks, including supervision of the operation of common trust funds. If the Board took action on the common trust fund proposals now under consideration, that action could not become effective for at least two months. It would be unfortunate if it became effective only shortly before the function was transferred. If such a situation appeared to be in the making, he thought the Board should delay action in order to see if the proposed transfer legislation would be enacted.

Governor Shepardson remarked that to him, as a layman, this was an extremely complex subject. It appeared to him that there was justification for some liberalization of the strict interpretation, but it would be wise to provide the type of safeguard Governor Robertson had mentioned to avoid danger to other trusts if one large participant should withdraw. He saw a little merit in combining the dollar and percentage restrictions on the size of individual participating trusts. It did not seem to him that common trust funds should be advertised as were mutual funds, yet he had no firm idea as to what restrictions should be placed on advertising. He believed that banks should be free to advertise their trust services, but it seemed a desirable safeguard to preclude advertising a particular fund and its earnings. Perhaps advertising limitations of the kind Mr. Masters had suggested would be desirable.

The size limitation on individual participating trusts might best be judged by efficiency of operating costs, Governor Shepardson continued. In the light of the rise in costs of all types of services, it could be that, whereas trusts of more than $100,000 previously had been considered able to afford individual trust services, they no longer could do so, and the limit should be increased to whatever was now the breaking point at which trusts could not afford individual service but had to resort to common trust funds. Setting the limit by that rule of judgment, coupled with the limitation on the percentage of the total fund

one participant might represent, should minimize whatever danger there might be in raising the ceiling.

As to the bona fide fiduciary purpose, Governor Shepardson believed that the strict interpretation was too narrow for many people, and there was justification for liberalization along the line Mr. Masters had discussed.

Governor King stated that he had had some experience with trust funds from the customer's point of view, and from that experience he could recognize some of the problems referred to by Governor Mills. Perhaps his (Governor King's) experience had not been typical, but he had not been well impressed with the quality of service rendered. He realized that that could be a harsh judgment, because his view involved only a few institutions. He thought that Governor Robertson's point as to what effect unhappy experiences in trust matters would have on the prestige of banking institutions as a whole was a very real consideration. Poor experience with the trust department could easily cause a person to lose respect for the entire institution.

Governor King did not believe banks should reach into the realm of mutual funds; they should be banks. He was in favor of having them get all the deposits they could, but he did not believe they should be in the investment business. The public was going to have some unfortunate experiences in investments, and he did not think it was wise for the Board to allow those experiences and their accompanying reactions to rest on the banking system of the country.

Definitions of common trust fund regulations should be as clear as possible. Perhaps a revocable trust should be limited in term, which might provide proof of its true trust character. In Governor King's judgment, a minimum term of five years would indicate that the trust was really not just a temporary investment; others might consider a different term preferable.

Governor Mitchell expressed the opinion that the commercial banks must participate in a growing economy. One of the Board's reasons for increasing the maximum rate of interest on time and savings deposits, effective January 1, 1962, was to enable banks to participate in economic growth. It should be remembered that the base of the commercial banking structure was growing in importance; the public was learning to use money more efficiently. If banks were allowed only to hold deposits, they would gradually shrink in importance and cease to be a vital factor in the economy. When people saved money it had to be invested by someone who would take responsibility for it. It was important that the savings of the country be invested as effectively and competently as possible. Banks would make mistakes, to be sure, but that would not deter Governor Mitchell from favoring investment by banks of a larger share of the national savings. He had confidence in commercial banking institutions and the men that ran them, and he thought they were as good as any one who could be found to perform the investing function. His general philosophical approach as to how to

get people who had savings to use them was to employ the banking structure as much as possible. If the economy was to be made to work, banks must be allowed to handle the savings. There was a lot of talent in banks, and they should be given a chance to exploit their ability.

In continuing, Governor Mitchell expressed the view that there should be a limit on the amount of individual participation in a common trust fund that would insure that the management of the fund would not give a disproportionate amount of attention to any particular trust. He thought that the percentage of the total fund that one trust might constitute should be small. As to advertising, it was his view that there was too much regulation, which should be minimized in a free economy. It did not bother him that people aggressively tried to make money by selling the services of their institutions. Any practice that might be questionable could be pointed up through examinations, and it was his impression that examination of a trust department or institution was more thorough than that of a non-trust institution.

Governor Balderston asked if the proposal before the Board would control an abuse of a common trust fund such as an aggressive trust company sending a short form of trust paper to its correspondents and offering them participations in its fund. He had reservations as to whether in broadening the uses of common trust funds the Board might be opening the door to practices that could not be controlled.

Mr. Masters responded that the trust investment committee of each trust institution must consider the appropriateness of each investment and the admission of each participant and record its approval in the institution's minutes. He could not imagine that any trust officer would countenance an abuse of the kind about which Governor Balderston had inquired. If any such situation should develop, the Board could adopt restrictive measures promptly.

Governor Mills commented that he could foresee that a situation that was a possibility now would become much more of a likelihood if trust services of banks were greatly expanded; the reasoning of this situation echoed the reasoning the Board had followed in its decision on the Morgan application last spring. The situation he had in mind was one in which trust institutions with authority to invest vast sums of money at their discretion would almost inevitably be tempted to favor investments in corporations that were closest to them as borrowers and depositors. There was also inherent in such a situation the danger that a trust institution would subscribe for such a substantial part of a new corporate issue that it would gain a dominant voice in the management of the company.

There was further discussion of certain types of institutions, the kinds of services they rendered, and possible overlapping of their services with those of trust institutions. Comments were also made as to the desirability, if bank services were to be expanded in the direction that had been proposed, of conducting those activities in a separate

department of the bank with an identification that would distinguish it from the trust department.

In concluding the discussion, Chairman Martin said that Mr. Masters had presented this problem most effectively for the Board's study, and he asked that copies of Mr. Masters' statement be distributed for further study. Personally, he had complete sympathy with Governor Mitchell's general position as to the service that the banks of the country might be expected to offer. He recalled some of the difficulties that had occurred in past years in securities distribution and investment of savings, and he suggested that a consideration for the Board was the public interest in terms of offering savers needed facilities. In his view, the banking business should be given a fair opportunity to compete for customers who had savings, assuming of course that there were adequate safeguards. The Board would want to bear in mind that, as more and more of these fields of service were removed from the regulated banking system, the banks would find their functions shrinking in relation to financial activities outside.

The discussion closed with the understanding that Mr. Masters' statement would be distributed for further study by the members of the Board prior to another meeting on the subject.

Governor Robertson then withdrew, as did all members of the staff except Messrs. Sherman, Hackley, and Solomon.

Continental Bank and Trust Company. On June 8, 1962, Mr. Hackley presented to the Board a memorandum dated June 7 outlining a discussion with President Swan of the Federal Reserve Bank of San Francisco by telephone concerning the possibility of a settlement of the Board's capital adequacy proceeding against The Continental Bank and Trust Company, Salt Lake City, Utah. At that time, the Board agreed that discussion of the matter would be carried over to a meeting when all members could be present. Governor Robertson had withdrawn from this meeting in keeping with the position he had taken that he would not participate in the discussion or consideration of any matters relating to the proceeding against Continental Bank.

At Chairman Martin's request, Mr. Hackley reviewed the discussion that he had had with Mr. Swan as presented in his memorandum of June 7. He stated that the seeming overture on the part of Mr. Sullivan, President of The Continental Bank and Trust Company, looking to an alternative plan for providing adequate capital that would in effect terminate the present proceeding had been presented on a confidential basis. The inquiry called first for some indication to Mr. Sullivan as to whether the Board would be receptive to any offer of settlement, or whether the Board would reject any offer of compromise because of its desire to obtain a judicial confirmation of its legal authority. Mr. Sullivan also sought to know whether, if the Board were to consider and reject such an offer of settlement, the fact that Continental had raised the question of such

an offer would prejudice its legal position in the present capital adequacy proceeding. Mr. Hackley stated that he had expressed the view in his memorandum of June 7 that nothing would be lost and much might be gained if the Board should express its willingness to consider a reasonable plan offered by Continental that might be regarded as bringing about reasonable compliance with Continental's condition of membership as to the maintenance of adequate capital. He went on to say that he still felt that it would be well to consider whatever offer Mr. Sullivan might wish to make, even though the mere consideration of such an offer possibly could be construed by some as an indication of a willingness to compromise. Such interpretation would not, in Mr. Hackley's opinion, be correct. Rather, the mere making of such an offer on the part of Continental would be tantamount to a concession by the bank of the Board's authority to require adequate capital of a member bank, and in any event it seemed most unlikely that any other bank would ever be willing to go to the lengths that Continental Bank had in challenging the authority of the Board. Thus, from the standpoint of the Board, Mr. Hackley said that he felt that an indication that the Board would be willing to permit Mr. Sullivan to meet with it for the purpose of discussing the question would not in any way weaken the Board's position in the proceeding.

On the question whether the Board might use a meeting solicited by Mr. Sullivan or an offer subsequently made by him to prejudice the

bank's position if no alternative settlement could be effected, Mr. Hackley felt there would be no reason why the Board should initiate the use of such information later in the proceeding. Such a discussion was not a part of the record and it would be a matter for Board decision whether Board Counsel might subsequently use such information. However, Mr. Hackley said that he believed the Board's position might be weakened if it rejected Mr. Sullivan's offer to discuss the question and if the bank subsequently included in the record a statement that the Board had turned down such an overture. The bank could contend that the Board was persecuting the bank and that its unwillingness even to consider an alternative settlement was an indication of such an attitude on the part of the Board. Therefore, if the Board was receptive to discussing the possibility of such an offer with Mr. Sullivan, Mr. Hackley felt that it should be only on the condition that if such a discussion did not lead to a settlement of the case, the bank would not introduce into the forthcoming proceedings any material relating to such discussion. In summary, Mr. Hackley said that, while he was not sanguine as to the outcome of any discussion such as Mr. Sullivan had inquired about, he could see nothing to be lost from the Board's standpoint in meeting with Mr. Sullivan and there was a possibility--even if remote--that this could lead to termination of the proceeding without in any way compromising the Board's position. According to Mr. Swan, Mr. Sullivan was prepared to come to Washington to meet with the Board for a preliminary discussion with the staff or with the

members of the Board. In the event the Board was willing to meet with Mr. Sullivan, Mr. Hackley felt that it would be preferable to present in writing to Mr. Swan the basis on which the Board would be willing to have such a meeting, including a stipulation that the Board would not use this in the show cause hearing scheduled to commence on July 23 and that it would not consider any such proposal without assurance on the part of Mr. Sullivan and the directors of his bank that, if the plan should not be accepted by the Board, the bank would not introduce into the record anything having to do with its submission.

Chairman Martin commented that he did not see how a condition such as Mr. Hackley suggested could be enforced against Continental. Counsel for the bank could, regardless of the Board's letter, at any time introduce such information into the proceeding. He noted that the Board had pursued this proceeding over a period of years and had spent a large sum of money in order to bring about adequate capital structure for Continental and to meet the challenge to the Board's authority to require such adequate capital. He did not see how the Board could provide a satisfactory answer to the Congress or to others as to why it had pursued the matter as it had and then been willing to consider or accept a settlement that did not accomplish the objectives of the proceeding.

Mr. Hackley responded that he thought there was an adequate explanation for such questions, provided any settlement that might be effected would, in the judgment of the Board, cause the bank's capital position

to be adequate. The Board's order of July 18, 1960, directed the bank to increase its capital by $1,500,000 within six months, but the order provided only one way in which the adequate capital might be provided, that is, through sale of common stock for cash. However, in issuing the order the Board had recognized that this was not the only way in which capital of the bank could be made adequate. Thus, there was at least an area for an alternative proposal which might clearly satisfy the need for adequate capital of the bank. If the bank were to submit an alternative that the Board in its judgment felt would provide reasonably satisfactory capital, the Board could issue a new order rescinding the 1960 order and directing the bank to carry out the alternative plan. Such a settlement need in no way be considered as a compromise of the Board's authority to require adequate capital. On the basis of Mr. Swan's comments, Mr. Hackley said that it appeared that Mr. Sullivan would be very happy to terminate the proceeding in some manner.

Chairman Martin stated that he could understand this feeling. However, if such a procedure were followed, how could the Board be sure that it had clearly established its right to require adequate capital? In other words, would the Board's position be as clearly established by that means as it would be if it continued the case through the courts and secured a favorable decision?

Mr. Hackley responded that he believed the Board's position could be clearly established in this manner. As a lawyer, he would

be happy to see a clear-cut decision by the court that said that the Board had the authority to require a bank to maintain adequate capital. If, however, an offer were to be made by Continental that was acceptable to the Board, the Board could say that the bank must comply with a new order which afforded adequate capital in accordance with the condition of membership, and in his judgment this would effectively sustain the Board's position.

In response to Chairman Martin's request for additional comments, Mr. Solomon stated that he had no views different from those expressed by Mr. Hackley. He did think that it would be awkward for the Board to be put in a position where a litigant could say that it had attempted to reach a reasonable compromise or settlement of a proceeding against it, and that the Board had insisted on litigating the matter to a final conclusion merely for the purpose of getting a judicial determination as to its authority. The litigant could then contend that the Board was putting the bank to expense and embarrassment simply for the purpose of making it a guinea pig.

Chairman Martin replied that this case had been going on for years, that the bank was the one that had challenged the Board's authority, that it clearly was not a case of the Board making the bank a guinea pig. It did not seem to him that the Board could easily justify the expense and effort that had gone into the proceeding thus far and, at this stage, permit itself to be put in a position of dickering for a

settlement. On the other hand, if Mr. Hackley was correct that the Board's authority could be clearly established, that was another matter. He had no objection to entertaining any suggestion that Mr. Sullivan might wish to make, but in his opinion it would be a mistake for the Board to be in a position of dickering with the bank on any basis that would not bear up in court later on if an offer were made and rejected by the Board. A charge of persecution had been made against one of the members of the Board for years in connection with this case and before it started, and he was not particularly concerned about the possibility that a firm position by the Board at this stage would hurt the Board because of any further charge of persecution. He did not think that it would be wise for the Board in any way to appear to be "soft" at this stage, that rather than be in such a position it would be wiser for the Board to take the position that this was just a case of carrying out the Board's responsibilities, that it had already spent a great deal of time and money in pursuing these responsibilities, and that its interest was in settling the issues in the right way as promptly as possible.

Governor King said that he was much inclined along the lines indicated by Chairman Martin's comments. However, he would want to explore the question whether it appeared that the Board might win the kind of clear-cut decision as to its authority that had been mentioned. He did not think that a failure to get such a decision would be disastrous,

but he did think that it would be undesirable if the Board now took a course that would leave unsettled the question of its authority under the statute. He would not be prepared to say that the Board would not consider a reasonable plan for settlement of the case. Neither did he think the Board should indicate to Mr. Sullivan that submission of an alternative plan would not prejudice the bank's case, although he would see no objection to telling Mr. Sullivan that he might present a proposal of any kind with assurance that if he did so the Board would not introduce that proposal into the record later on. It was possible that Mr. Sullivan was genuinely interested in settling the case on some reasonable basis; even though the Board might not "win" the case in the courts, it might get a settlement that was virtually complete as far as its order for providing adequate capital was concerned. Governor King said he also would be interested in Mr. Hackley's judgment as to how long the present proceedings might continue if carried on to their ultimate legal conclusion.

Mr. Hackley responded that he could not judge how long such litigation might continue, but he would not be optimistic about an early conclusion. The show cause hearing scheduled for July 23 could last for a few weeks or conceivably it could extend over a period of a year or two or more. If, after that, the Board were to issue an order requiring the bank to forfeit membership, and if that were litigated, the case could go on for years. As Governor King's remarks indicated, there was no assurance that the Board would win the case in the end. It was because of these and the other considerations mentioned in the

discussion this morning that he felt it would be appropriate for the Board to permit Mr. Sullivan to meet with it on the possibility that there might be an offer of an alternative to further legal proceedings that would put the bank in a reasonable capital position.

Governor Mills said that he would be willing to hear what Mr. Sullivan had to say. Thus far the approach of Mr. Sullivan had been informal, and it was his judgment that it would be preferable not to write a letter to Mr. Swan or to Mr. Sullivan setting down any conditions. If Mr. Sullivan or anyone else from his bank wished to discuss this question with members of the staff and in so doing to offer a compromise of some sort, that would be quite in order. He noted that the bank had retained earnings and there was a question how far it was now out of line with the capital position of similar banks. Another question was how far the bank had corrected its banking practices that had been objected to earlier--things that were ordinarily curable by examination procedure.

Mr. Solomon said that his impression was that the bank's capital position had improved since 1960 but that it was still not in a particularly favorable capital position, that there would still be a substantial shortage of capital according to their analysis.

Governor Shepardson commented that the fact that the Board might ultimately lose the case in the courts would not bother him. This would then pave the way for requesting needed legislation to establish

the Board's authority in this area. In the meantime, he would have no objection to talking with Mr. Sullivan and if he wished to submit a plan to provide adequate capital, he would be quite willing to consider such a proposal.

Chairman Martin suggested that the Board proceed along the lines indicated by Governor Mills--that is, let Mr. Sullivan know that the Board would listen to him, but not put any conditions in writing. The Chairman also suggested that, in informing Mr. Swan that Mr. Sullivan might feel free to present anything he wished to the Board, he also be informed that the Board was not in a position to say whether his doing so would prejudice Continental's case. Further, he should not be given any assurance that the Board would not use that information subsequently if no settlement were reached.

No disagreement with Chairman Martin's suggestions was indicated.

The meeting then adjourned.

Secretary's Note: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board increases in the basic annual salaries of the following persons on the Board's staff, effective the dates indicated:

W. Sutton Potter, Senior Attorney, Legal Division, from $8,080 to $8,955 per annum, effective July 22, 1962.

Herbert H. Hagler, Review Examiner, Division of Examinations, from $8,860 to $9,120 per annum, effective July 8, 1962.

Mary L. Morris, Stenographer, Division of Examinations, from $3,970 to $4,145 per annum, effective July 8, 1962.

Governor Shepardson today approved on behalf of the Board memoranda from the Division of Administrative Services dated June 12 and June 15, 1962, recommending:

(1) Establishment of a new position of Operator (Mimeograph) in the Duplicating, Mail, Messenger and Supply Section of the Division; and employment of one Operator (Mimeograph) at Grade PG-6, subject to determination by the Division of Personnel Administration through normal classification process.

(2) Establishment of an additional position of Operator, Tabulating Equipment, in the Division; and appointment, with full employee status, of Charles W. Wrenn, presently Operator, Tabulating Equipment (temporary appointee), to fill the position, subject to normal review by the Division of Personnel Administration with regard to promotion and transfer from within the Board.

Secretary

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

Item No. 1
6/26/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 26, 1962.

Board of Directors,
The Drovers National Bank of Chicago,
Chicago, Illinois.

Gentlemen:

The Board of Governors of the Federal Reserve System has given consideration to your application for fiduciary powers and grants The Drovers National Bank of Chicago authority to act, when not in contravention of State or local law, as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State of Illinois. The exercise of such rights shall be subject to the provisions of Section 11(k) of the Federal Reserve Act and Regulation F of the Board of Governors of the Federal Reserve System.

A formal certificate indicating the fiduciary powers that your bank is now authorized to exercise will be forwarded in due course.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

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

Item No. 2
6/26/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 26, 1962

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

Dear Mr. Hughes:

This is in response to your Legislative Referral Memorandum of June 6, 1962, requesting the views of the Board on a draft bill proposed by the Department of the Treasury "To place authority over the trust powers of national banks in the Comptroller of the Currency."

This draft bill transfers from the Board to the Comptroller authority (1) to grant to national banks the right to act in fiduciary capacities, and (2) to regulate the exercise of fiduciary powers by national banks, including the operation of common trust funds.

This is to advise that the Board favors enactment of the proposed legislation.

Very truly yours,
(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 3
6/26/62

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

AIR MAIL - REGISTERED
RETURN RECEIPT REQUESTED

June 26, 1962

Mr. Peter W. Billings,
Fabian & Clendenin,
Continental Bank Building,
Salt Lake City 1, Utah.

Re: In the Matter of The Continental
Bank and Trust Company

Dear Mr. Billings:

This is to advise you of the Board's decision with respect to your request, by letter to the Board dated June 4, 1962, that the Show Cause Hearing in the above matter scheduled for July 23, 1962, be held in some public building other than the Salt Lake City Branch of the Federal Reserve Bank of San Francisco. As you were informed by the Board's letter of June 8, 1962, Board Counsel were given an opportunity to submit comments on your request before June 18, 1962. In accordance therewith, a Statement of Board Counsel in opposition to your request was submitted to the Board under date of June 14, 1962, and service upon you of a copy of such Statement has been certified to the Board.

After consideration of your request and the Statement in Opposition thereto, the Board has decided that the nature of the Federal Reserve Bank Branch building in Salt Lake City and access thereto are not such as to deter or inhibit public attendance at the Hearing. Accordingly, the Board finds no reason to modify its prior Orders designating the Salt Lake City Branch building as the place of hearing, and your request is therefore denied. However, your attention is invited to section 263.3 of the Board's Rules of Practice, which provides as follows:

> "Each hearing shall begin at the time and place ordered by the Board, except that, where a hearing examiner has been designated to conduct a hearing, the time and place for beginning such hearing may, for good cause shown, be changed by the hearing examiner. Thereafter, the hearing may be successively adjourned to such time and place as may be ordered by the Board or by the hearing examiner."

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 4
6/26/62
June 26, 1962

2371

TO ALL MEMBERS OF THE BOARD'S STAFF:

The Board today approved the following policy on Employee-Management Cooperation, effective July 1, 1962:

I. Purpose. To establish the basic policy of the Board with respect to recognition of employee organizations.

II. Policy. Employees of the Board of Governors of the Federal Reserve System shall have, and shall be protected in the exercise of, the right, freely and without fear of penalty or reprisal, to form, join, and assist any employee organization or to refrain from any such activity.

As used in this policy the term "employee organization" means any lawful association, labor organization, federation, council, or brotherhood having as its primary purpose the improvement of working conditions among Federal employees, or any craft, trade, or industrial union whose membership includes both Federal employees and employees of private organizations; but such term shall not include any organization (1) which discriminates with regard to the terms or conditions of membership because of race, color, creed, national origin, or sex, or (2) which asserts the right to strike against the Government of the United States or any agency thereof, or to assist or participate in any such strike, or which imposes a duty or obligation to conduct, assist, or participate in any such strike, or (3) which advocates the overthrow of the constitutional form of government in the United States.

III. Rights Retained by Employees. Recognition of employee organizations, in whatever form accorded, shall not preclude any employee, regardless of employee organization membership, from bringing matters of personal concern to the attention of appropriate supervisors or officials of the Board in accordance with procedures heretofore or hereafter established by the Board, or from choosing his own representative in a grievance or other action.

IV. Rights Retained by Management. The Board retains the exclusive right, under the provisions of the Federal Reserve Act, as amended, to determine the management of its internal affairs.

V. Procedures. Employees or their representatives wishing to secure recognition by the Board of their employee organizations should submit their request in writing to the Director, Division of Personnel Administration.

VI. Revisions. The Board may revise the above policy and any procedures formulated thereunder as it may deem necessary in the interest of effective employee-management cooperation, with due regard to the right of employee organizations to be heard or consulted.

DIVISION OF PERSONNEL ADMINISTRATION