

609  
9/62

Minutes for September 14, 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	<u>M</u>
Gov. Mills	<u>[Signature]</u>
Gov. Robertson	<u>R</u>
Gov. Balderston	<u>CCB</u>
Gov. Shepardson	<u>[Signature]</u>
Gov. King	<u>[Signature]</u>
Gov. Mitchell	<u>[Signature]</u>

Minutes of the Board of Governors of the Federal Reserve System on Friday, September 14, 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. Young, Adviser to the Board and  
 Director, Division of International  
 Finance  
 Mr. Fauver, Assistant to the Board  
 Mr. Solomon, Director, Division of  
 Examinations  
 Mr. Holland, Adviser, Division of  
 Research and Statistics  
 Mr. Koch, Adviser, Division of Research  
 and Statistics  
 Mr. Brill, Associate Adviser, Division of  
 Research and Statistics  
 Mr. Furth, Adviser, Division of Inter-  
 national Finance  
 Mr. Mattras, General Assistant, Office of  
 the Secretary  
 Mr. Eckert, Chief, Banking Section, Division  
 of Research and Statistics  
 Mr. Yager, Chief, Government Finance Section,  
 Division of Research and Statistics  
 Mr. Keir, Senior Economist, Division of  
 Research and Statistics

Money market review. There were distributed tables relating to the preliminary results of, and the extent of dealer participation in, the current Treasury advance refunding operation, along with a table summarizing monetary developments during the four-week period ended September 12, 1962.

9/14/62

-2-

Mr. Yager commented on the results of the refunding operation and discussed other developments in the Government securities market, following which Mr. Holland reviewed recent trends in bank loans, the money supply, and bank reserves.

All of the members of the staff then withdrew except Messrs. Sherman, Kenyon, Fauver, Solomon, and Mattras, and the following entered the room:

Mr. Hexter, Assistant General Counsel  
 Mr. Daniels, Assistant Director, Division  
 of Bank Operations  
 Mr. Kiley, Assistant Director, Division  
 of Bank Operations  
 Mr. Leavitt, Assistant Director, Division  
 of Examinations

Discount rates. The establishment without change by the Federal Reserve Banks of New York, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, and Dallas, on September 13, 1962, of the rates on discounts and advances in their existing schedules was approved unanimously, with the understanding that appropriate advice would be sent to those Banks.

Circulated or distributed items. The following items, which had been circulated or distributed to the Board and copies of which are attached to these minutes under the respective item numbers indicated, were approved unanimously:

Item No.

Letter to The Gallatin Company, Inc., New York, New York, granting consent to a change in the location of its principal office from 70 Broadway to 350 Park Avenue.

1

9/14/62

-3-

Item No.

- Letter to Provident Tradesmens Bank and Trust Company, Philadelphia, Pennsylvania, approving a change in the location of an approved branch in Gladwyne. 2
- Telegram to the Federal Reserve Bank of Atlanta interposing no objection to proceeding with the west addition to the head office building. 3
- Letter to Security Bank & Trust Company of Bozeman, Bozeman, Montana, approving an investment in bank premises. 4
- Letter to the Federal Reserve Bank of Minneapolis regarding Board approval of the investment in bank premises by Security Bank & Trust Company of Bozeman, Bozeman, Montana. (With the understanding that edited copies would be sent to the Presidents of all Federal Reserve Banks.) 5
- Letter to the Federal Reserve Bank of San Francisco regarding the question of republication of certain reports of condition of Fidelity Bank, Beverly Hills, California. 6
- Letter to Wells Fargo Bank, San Francisco, California, approving an extension of time to establish a branch in Sacramento County. 7
- Letter to the Chairman of the Conference of Presidents noting without objection a proposal to engage the services of Stanford Research Institute for a study of the feasibility of mechanizing the currency sorting and counting operations of the Federal Reserve Banks. 8

All of the members of the staff then withdrew except Messrs. Sherman, Kenyon, Solomon, and Leavitt, and the following entered the room:



9/14/62

-4-

Mr. Chase, Assistant General Counsel 1/  
 Mr. O'Connell, Assistant General Counsel 1/  
 Mr. Shay, Assistant General Counsel  
 Mr. Powell, Special Counsel to the Board 1/  
 Mr. Stephenson, Special Assistant, Division  
 of Examinations

Continental Bank and Trust Company. Governor Robertson requested that the record show that although he would remain in the room for the following discussion of a matter relating to the administrative proceeding against The Continental Bank and Trust Company, Salt Lake City, Utah, he would not participate in the discussion or any action taken by the Board, in accordance with his long-standing position of having withdrawn from participation in the matter.

Since the previous discussion by the Board of the Continental case, there had been distributed to the Board: (1) letter dated September 6, 1962, from Kenneth J. Sullivan, President of Continental, detailing the terms of a proposal to increase the capital of the bank as a possible basis for termination of the administrative proceeding against the bank; (2) memorandum from Messrs. Chase and Powell, Board Counsel, commenting on Mr. Sullivan's letter; and (3) memorandum from the Division of Examinations dated September 13, 1962, analyzing the offer of settlement and submitting certain statistical data prepared by the Division of Bank Operations.

At the Board's request, Mr. O'Connell commented briefly on the conversations he had held with Mr. Sullivan in Salt Lake City

1/ Counsel to the Board in the matter of Continental Bank and Trust Company.

9/14/62

-5-

pursuant to the instructions given by the Board on August 29, 1962. (Mr. Ahlf, Chief Examiner of the Federal Reserve Bank of San Francisco, also participated in these conversations.)

Mr. O'Connell said he had made Mr. Sullivan aware of certain difficulties seen in the proposal that the latter had made orally to President Swan of the San Francisco Reserve Bank, as reported in Mr. Swan's memorandum of August 18, 1962. Also, he had made it clear to Mr. Sullivan that he was not in Salt Lake City in the role of bargainer, but rather to receive any alternative proposal that Mr. Sullivan might care to make. Subsequently, he had expressed certain personal views with regard to alterations in the proposal suggested by Mr. Sullivan. Mr. Sullivan then either withdrew those modifications or placed them in a form he thought might be acceptable to the Board, without further suggestions on the part of Mr. O'Connell.

Mr. O'Connell said he believed Mr. Sullivan was sincere in what he proposed to do with Continental Bank. It was Mr. Sullivan's expressed purpose to proceed toward normal banking operations. He felt that Continental had suffered by virtue of the pendency of the administrative proceeding and pointed out that it had not grown in proportion to other banks in the area. The only solution, as Mr. Sullivan put it, was to move as soon as possible into normal banking operations, in a framework suitable to System

9/14/62

-6-

membership, and to work like other member banks with the Board and the Federal Reserve Bank of San Francisco. If the Board were to reject the proposal, however, Mr. Sullivan indicated that he would have no alternative except to litigate the matter until an ultimate court decision was rendered. Both Mr. Sullivan and Mr. Billings, Counsel for Continental, who was called in by Mr. Sullivan when his letter was ready for transmittal to the Board, expressed the view that "no matter who wins the case, no one will win." Although Mr. Billings was willing to continue the case and thought Continental was correct in its argument regarding capital, he expressed the judgment that the Sullivan proposal was the best workout in the circumstances.

Chairman Martin then suggested that Mr. Powell review the points he had made at the Board meeting on September 7, along with any other points he would like to make.

In his initial comments, Mr. Powell said he looked upon his role at today's meeting as one of advising a client of long-standing as to what he thought was in the client's best interest. His recommendation would not be influenced by the fact that a continuation of the case would result in the payment of further fees to his firm, or by anticipation of the "professional victory" that he was convinced he could win for the Board if the case were carried through to an orderly completion.

9/14/62

-7-

Mr. Powell went on to say if Mr. Sullivan had come to the Board with a proposal that beyond any doubt would result in Continental Bank becoming adequately capitalized, he (Mr. Powell) would be the first to recommend that the Board accept it and terminate the proceeding. In his view, however, the present proposal was not of that nature. Therefore, it was his unpleasant duty to recommend that the Board complete the capital adequacy proceeding in an orderly way and decide the case in the normal course of events on the basis of the evidence contained in the record.

The Board was on notice, Mr. Powell said, that the addition of \$1,100,000 of capital, as proposed by Mr. Sullivan, would still leave Continental with a substantial dollar deficiency under every capital ratio and formula recognized by the Board in its order and statement of July 18, 1960. The Board also was on notice that in the judgment of experienced bank supervisors who were to appear at the show cause hearing, now scheduled to begin on October 15, 1962, the character of the bank's operations required even more capital for depositor protection than the amounts indicated by the several ratios or formulas or by the median capital of banks in the same size group.

Mr. Powell reminded the Board that the adversary proceeding was now at an advanced stage. This was not a case where a member



9/14/62

-8-

bank with inadequate capital was cooperating with the bank supervisors and came in with a plan that eventually would correct its capital deficiency. Continental had refused to cooperate to this end over a period of many years. Instead, it had insisted on a public and formal adversary proceeding to test the statutory authority of the Board to require a member bank to maintain adequate capital and to test the ability of the Board to prove the capital requirement of a bank. The administrative proceeding instituted some six years ago had been widely publicized as a test case of first impression on the two points as to which Continental had challenged the Board. In its 1960 order the Board concluded that it had the authority to require adequate capital. It also defined a method of determining a bank's capital requirement, along with the adequacy of a bank's capital. All that remained was for the Board to determine whether Continental's membership in the Federal Reserve System should now be terminated. This would require simply a stipulation of facts and a few days of hearings, following which the matter would be submitted to the Board by the Hearing Examiner. There would be briefs of Counsel, and there could be oral argument if the Board so desired.

It was Mr. Powell's opinion that the Board would prejudice its position in the field of regulation of bank capital if at this stage it terminated the proceeding on any basis that would not result in Continental's having adequate capital. The Board would



9/14/62

-9-

in effect be repudiating its own method of establishing capital adequacy, as laid down in the 1960 order and statement. Also, it would in effect be establishing lower standards of capital for member banks than indicated by the application of accepted capital ratios and formulas. The Board's action would doubtless be interpreted as indicating lack of confidence in its legal position in this field of regulation.

Mr. Powell noted at this point that he was familiar with the memorandum from the Division of Examinations dated September 13, 1962, and the attached statistical data. His further comments would be made in the light thereof.

Mr. Powell then commented that under all of the bank capital ratios and formulas recognized by the Board in its 1960 order and statement, Continental would continue to have a capital deficiency of substantial dollar proportions after the addition of the \$1,100,000 of new capital contemplated by the Sullivan proposal. He warned the Board not to be misled by percentages. According to some of the statistical studies, Continental would appear to have, after effectuation of the Sullivan proposal, a fairly high percentage of the capital required under the various ratios and formulas. However, depositors must be paid in dollars, and Continental would still have a substantial deficiency in terms of dollars.

At this point Mr. Powell distributed to the members of the Board a table which showed in one column Continental's actual

9/14/62

-10-

capital plus valuation reserves as of June 30, 1962, and then showed the dollar amount of the bank's indicated deficiency on that date-- both before and after taking into consideration Mr. Sullivan's offer-- on the basis of three capital ratios or formulas and also in relation to the median primary risk-asset ratio of all member banks in the same size group.

After describing in some detail the figures shown in the table, Mr. Powell brought out that, after giving effect to the Sullivan proposal, Continental's capital deficiency would still range from \$700,000 to \$1 million. He also brought out that the deficiency suggested by the Form for Analyzing Bank Capital (\$825,000) reflected various adjustments that had been made in favor of Continental. If the raw formula had been applied, it would show Continental's capital requirement to be \$8,472,000 rather than \$7,325,000.

Mr. Powell then distributed copies of the Form for Analyzing Bank Capital prepared in such manner as to show an "average" based on the December 30, 1961, call reports of all member banks. This indicated that the "average member bank" had 104.9 per cent of the capital requirement. He added that on the basis of using published information only, certain factors could not be included in this computation, such as the amount of classified assets. Nevertheless, the paper he had distributed

9/14/62

-11-

seemed to show rather conclusively that the so-called ABC form was not unduly harsh on banks. On the other hand, if no special adjustments were made in its favor, Continental had only 76 per cent of the capital requirement indicated by the form even after giving effect to the Sullivan proposal.

Mr. Powell also referred to one further statistical comparison, namely, Continental's average primary risk-asset ratio of 10.5 per cent for the year 1961, which compared with a median of 15.9 per cent for all member banks in the Twelfth District and a 13.3 per cent median for all member banks in its size group. He noted that it would have required additional capital of \$2,315,000 to bring Continental's ratio up to the median of all banks in its size group, or \$1,215,000 after giving effect to Mr. Sullivan's offer.

The foregoing, Mr. Powell said, was the basis for his statement that under no recognized or accepted capital ratio or statistical comparison would Mr. Sullivan's proposal render Continental's capital adequate. It would fall short by rather substantial dollar amounts ranging from \$700,000 to as much as around \$1,200,000. As the Division of Examinations had pointed out, however, this was only the starting point in determining whether a bank's capital was adequate. Even more important was the experienced judgment of bank supervisors, formed in the light

9/14/62

-12-

of the characteristics of a particular bank's operations. It was the unanimous judgment of the bank supervisors who were to testify at the show cause hearing that a number of factors would call for Continental to have an even more substantial capital account than the so-called "average bank." He had enumerated some of the principal factors in the memorandum submitted to the Board prior to this meeting. However, he would like to call attention to one or two of these points in the light of the new statistics that had been prepared by the Division of Bank Operations.

One was Continental's role as the key bank in a chain and as credit correspondent bank for a large number of relatively small banks. Thus, 9.68 per cent of Continental's total deposits as of June 30, 1962, consisted of deposits of other banks, compared with a median of 1.13 per cent for all banks in its size group. From the report of examination of Continental made as of January 8, 1962, there were 52 banks--if he recalled correctly--that were carrying substantial deposits with Continental, and 15 carried more than 40 per cent of their total cash and due from banks in the form of deposits with Continental. Thus, if Continental got in trouble those 15 banks would be in serious difficulty and 52 banks in the area would be hurt by the loss of all or part of their substantial deposits carried with Continental.

9/14/62

-13-

Also, Continental traditionally had low net earnings. Vice President Crosse of the New York Reserve Bank felt that the Board should not depend on any future retention of earnings to correct the current capital inadequacy. In Mr. Crosse's opinion, Continental would need all of them to keep its capital adequate in the light of the growth that might be expected once the administrative proceeding was concluded. This might be the reason, Mr. Powell suggested, why Mr. Sullivan had made no commitment to retain any given amount of future earnings.

Additionally, Continental had followed the practice of selling substantial amounts of loans to other banks. It stood ready to repurchase those loans whenever requested, and their total ran around \$2.9 million.

Further, Continental had the reputation of being extremely liberal in making loans and even boasted of that fact in its annual report to stockholders. This was borne out by examinations of the bank. Continental continued to be a heavily loaned bank, with 54 per cent of its total assets in loans as of June 30, 1962, compared with a median of 48 per cent for banks in its size group. Its bond portfolio was relatively small compared with other banks in the group, amounting to only 64 per cent of the median figure. It continued the practice of holding a large part of its portfolio in long-term bonds and had \$500,000 market depreciation in its bond account as of the January 1962 examination date.



9/14/62

-14-

Continental also continued to have a large part of its capital account committed to fixed assets, which would be of little value if the time came when it was necessary to obtain cash to pay off depositors. Continental had 41 per cent of its capital account in such assets compared with a median of 17 per cent for all banks in its size group. Giving effect to the addition of capital proposed by Mr. Sullivan, Continental's figure would be 33 per cent. If Continental should increase its investment in fixed assets to the extent suggested by the Sullivan offer, its figure would be 36 per cent.

The bank's depositors did not have the protection of an independent board of directors. This had given rise to a number of management practices for which Continental had been severely criticized in the past. As pointed out, the most important intangible factor in determining the capital requirement of any bank is management.

Mr. Powell said he did not doubt that Mr. Sullivan sincerely wanted to get rid of the capital adequacy proceeding. It was a bother and an expense to him. However, Mr. Sullivan did not represent new management in Continental. He had been former President Cosgriff's chief of staff during the entire period since the bank became a State member bank of the Federal Reserve System.

9/14/62

-15-

In fact, according to the record of the proceeding, Mr. Sullivan actually had more to do with the running of the bank than Mr. Cosgriff. True, Mr. Cosgriff could overrule Mr. Sullivan. Nevertheless, Mr. Sullivan was the man operating the bank and the man responsible for a great many, if not most, of the problems that Mr. Powell had just enumerated. He was president of the bank during the time Mr. Cosgriff was a director of the Reconstruction Finance Corporation. As the Board would recall, several years ago it was necessary to issue a section 30 warning to Mr. Sullivan for over-drawing his checking account because of bank stock speculation. In the course of this proceeding, Mr. Sullivan had bragged about the Paramount Life Insurance Company arrangement and remarked that the bank examiners were not supposed to have uncovered it. Also, Mr. Sullivan was responsible for one of the riskiest loans on the books of Continental today. He had been one of the most hostile and adamant witnesses to appear in this case. Immediately after Mr. Cosgriff's death, Mr. Sullivan and his fellow officers--sitting as a board of directors--voted themselves substantial salary increases even though the bank was already subject to criticism for having such a large group of senior officers when the bank had a low capital structure and needed more retained earnings to bring up its capital. Also, Mr. Sullivan was responsible for the window-dressing at the end of 1961 when

9/14/62

-16-

Continental's deposits were artificially inflated so as to misrepresent the bank's true position to stockholders and depositors. Not even Mr. Cosgriff had engaged in that practice. If Hearing Examiner Woodall was in fact improperly influenced, Mr. Powell said, it was Mr. Sullivan who did it. He entertained Mr. Woodall and made the bank's car available to him, a matter for which Mr. Woodall had been criticized. In summary, Mr. Sullivan unfortunately did not represent a fresh breath of new management blowing over the Continental situation. On the basis of the facts that appeared in the record, he was not the model of a modern member banker. This was a factor that the Board should bear in mind, in view of the fact that management was one of the most important intangible factors that the Board had to evaluate.

The Board should also bear in mind that the Federal Deposit Insurance Corporation, a sister regulatory agency with an important stake in this matter, would have a representative appear at the show cause hearing. This representative had advised Board Counsel that in his view Continental should be required to increase its capital in the amount of \$2 million.

This was a test case, widely publicized, as illustrated by the September 10, 1962, issue of the American Banker, which contained a lead article of the kind that was likely to be published freely. The article suggested that bankers would be watching closely the

9/14/62

-17-

hearing in Salt Lake City. That was why the Board should not accept an offer of settlement that did not result in complete adequacy of capital.

During the course of Mr. Powell's remarks, Chairman Martin was called from the Board Room. After Mr. Powell had concluded his comments, the Vice Chairman called upon Mr. Solomon.

Mr. Solomon said there were two points he would like to make by way of general background. First, the Division of Examinations was very much interested in the question of capital adequacy, which was right at the heart of bank supervision. It was extremely important that the Board exercise powers in this field in order to assure sound bank supervision. Second, he felt that the Board had been well served by Mr. Powell in this proceeding. Mr. Powell had worked long and diligently, with good results. The court decisions that had been obtained thus far would be valuable to the Board in any case in the future. Mr. Powell had kept unremitting pressure on this case; otherwise, the Board probably would not have before it the present offer of settlement.

Turning to the capital position of Continental, and what it would look like after the adjustments resulting from Mr. Sullivan's offer, Mr. Solomon said the questions that had arisen between the Division of Examinations and Mr. Powell from a statistical standpoint had been substantially resolved. He did

9/14/62

-18-

not think there was any substantial difference of opinion as to where the figures came out at this stage. Continental's capital totaled about \$5.4 million on June 30, 1962, and most of the appraisals would say that the bank needed in the neighborhood of \$7.4 million. Thus, Continental's capital was roughly \$2 million below what might be regarded as the optimum.

As to the Form for Analyzing Bank Capital, Mr. Solomon noted Mr. Powell's comment that every conceivable adjustment had been in favor of Continental. The Division of Examinations would prefer to say that reasonable and appropriate adjustments had been made. However, the view that Continental should have from \$7.3 million to \$7.5 million of capital to be in an optimum position seemed quite generally recognized.

The next question was how completely and how rigidly the Board was going to insist that a bank conform to such a standard. Many banks did not have that kind of a capital position. Effectuation of the Sullivan proposal would mean that Continental would have about 87 per cent of the \$7.4 million of capital that might be regarded as the optimum figure. True, the bank had certain characteristics that would make it desirable for the bank to have fairly close to the optimum level, particularly when it was acting as the key bank of a group of banks. Something in the neighborhood of 90 per cent of the optimum capital should be looked for from this bank. However,



9/14/62

-19-

Mr. Sullivan was now making a proposal that would place the bank at about 87 per cent. Certain factors could be mentioned as requiring somewhat more capital than indicated by statistical measures, but many of those were already taken into account in the Form for Analyzing Bank Capital. These included funds due to other banks, the relatively high ratio of loans to deposits, the level of the Government bond portfolio, the longer-than-average maturity of the portfolio, and the relatively high amount of fixed assets. Where it was indicated by the form that Continental needed about \$7.3 to \$7.5 million of capital, these things had been taken into account.

Mr. Solomon agreed with Mr. Powell that a great deal depended on management. Here, however, the matter began to get into intangibles. No one could say for certain what kind of man Mr. Sullivan was, but the Federal Reserve Bank of San Francisco had found him to be a man of his word, even despite the strained relationships with Continental Bank. Mr. Solomon noted that a man is not the same person when second in command as when he is first in command. While it was true that Mr. Sullivan was first in command at Continental during the period when Mr. Cosgriff was with the Reconstruction Finance Corporation, Mr. Solomon doubted that he was more than nominally in full control of the bank. Thus, it seemed appropriate to take into account the changed circumstances under which Mr. Sullivan was operating. It seemed almost inconceivable that Mr. Cosgriff

9/14/62

-20-

would have made an offer of settlement, unless perhaps some nominal offer. He had said that Continental would never put up \$1 of capital by selling additional stock. Mr. Sullivan's offer included the sale of stock--and in more than a nominal amount, in fact a little over half a million dollars.

With regard to the window-dressing operation referred to by Mr. Powell, Mr. Solomon said he would not want to defend window-dressing in principle or in this specific case. As he understood it, however, in this case the window-dressing was engaged in for a reason other than to give an impression of large figures. Instead, it was done for tax purposes. Treasury regulations prescribe that certain things shall be added together to find the basis for the bad debt reserve. Thus, it is desirable tax-wise for a bank to have a high base for the bad debt reserve. The higher the base, the more of a bank's earnings can be set aside tax free to go into the reserve. As far as bank supervisors are concerned, the larger the bad debt reserve the better. The procedure followed by Continental followed the Treasury regulations, and Mr. Solomon felt certain that other banks had done the same thing. In fact, this window-dressing operation gave Continental an adverse appearance at the end of the year as far as capital ratios were concerned, since it indicated a very heavily loaned position.

9/14/62

-21-

Summarizing Continental's capital situation, Mr. Solomon said that, giving consideration to Mr. Sullivan's offer, the bank would have about 87 per cent of what would be considered by any of the well-recognized measures as optimum capital. No one would contend that this was an abundant capital position. On the other hand, he did not consider it an extremely low or unreasonable capital position. It was for the Board to decide, of course, whether in the particular posture of this case it would be desirable to pursue the capital adequacy proceeding to a finish. This involved the question whether further prosecution of the matter, after an offer such as Mr. Sullivan had made, would be regarded as vindictive and an attempt to harass this particular institution.

Governor Mills noted that Mr. Sullivan had refused to admit the authority of the Board to require a bank to provide additional capital. He inquired whether it was felt that a man who had served as second in command of a bank for many years and had acceded to the unsound banking practices of his superior was the kind of man who could be expected to change his habits. He inquired whether Mr. Solomon would like to see in charge of a bank an individual who, if he disputed the soundness of the practices followed by the institution, nevertheless remained a party to them.

Mr. Solomon replied in terms that he thought the principal quarrel that the Federal Reserve System had had with this bank related to the capital situation. The bank had been criticized for various practices, but in general they traced back to the question of

9/14/62

-22-

capital. The bank had taken certain risks. However, if the bank had had adequate capital, they would not have been flagrant risks.

Governor Mills indicated that he could not agree with this statement.

Governor Balderston noted that Continental kept its books on a cash rather than an accrual basis. Some of the figures that had now been placed before the Board were based on end-of-June data. He inquired whether it appeared that at some other time of year, such as the end of March, the figures would have looked better or worse.

Mr. Solomon replied that there appeared to be a time in the spring of each year when Continental's capital position looked most favorable. In March of this year its position looked more favorable than it did at the end of the preceding December or at the end of June. This was also true in April 1961. The figures at that season of the year did not seem truly representative of the bank's situation; the end-of-June figures seemed to come closer to reflecting an average picture of the bank.

Chairman Martin returned to the room at this point.

In further reference to Governor Balderston's question, Mr. Powell said that the Form for Analyzing Bank Capital had been applied to Continental for examination dates going back to 1951. The results showed that regardless of the time of year when the



9/14/62

-23-

examinations were made, a substantial deficiency of capital was indicated. There were certain times of the year when the bank appeared better capitalized than at other times, but the capital deficiency of Continental was apparent despite the time of year at which examinations took place.

With regard to Continental's method of bookkeeping, Mr. Powell noted that in 1957 a special study was made by a certified public accountant because the bank contended it had hidden reserves. This study showed that there were no hidden reserves arising out of the cash method of bookkeeping. One reason for making the 1962 examination in the early part of January was to catch the bank at a time when it had just made its payments of interest on savings accounts and when it had just made dividend disbursements. In this manner the Reserve Bank was trying to get a true picture. The bank, because it did not keep its books on an accrual basis, tended to look artificially good just before the payment of dividends and interest.

Chairman Martin then turned to Mr. O'Connell, who began his remarks by expressing concurrence in Mr. Solomon's commendation of Mr. Powell. Mr. O'Connell also made it clear that if the Board should reject the offer of settlement he would continue to work closely with Mr. Powell and Mr. Chase in pursuance of the Board's position to the point of the most favorable decision that could be reached.



9/14/62

-24-

As to the validity of Mr. Sullivan's proposal, Mr. O'Connell said that he had tried to measure it against several considerations that he felt the Board must bear in mind. After considerable thought and study, he could not concur in the recommendation of Mr. Powell. To the contrary, in his judgment the proposal submitted by Mr. Sullivan -- which he viewed as in effect a proposal of Continental Bank -- constituted a reasonable basis for termination of the administrative proceeding, which was now in its sixth year. As the basis for his judgment, Mr. O'Connell outlined the considerations mentioned in the following paragraphs.

The first question was the extent to which the Board's purposes in originally instituting this proceeding would be realized by acceptance of the offer. The Board's original purposes were to determine whether the capital position of Continental was adequate; and, if it was not, the extent of the inadequacy and the period of time that should be allowed for the bank to increase its capital. The bank's capital had been found inadequate, but the bank had refused to increase its capital. Thus, the next question was whether its membership in the Federal Reserve System should be terminated.

In large part these points had been resolved in the course of the proceeding. A rather clear and adequate record was before the Board on the bank's capital position, and the Board's determination

9/14/62

-25-

as to the amount of additional capital that should be provided by the bank was a matter of record. The ultimate issue was whether the bank's membership in the System should be terminated.

As to the Board's statutory authority to require a bank to provide adequate capital, if the Board should go forward with the case, it was quite possible that the Board would get a judicial statement confirming its statutory authority. On the other hand, the one certain thing in litigation is uncertainty as to the outcome. The Board might never obtain a judicial statement regarding its statutory authority in as full and complete form as it would desire. Also, there was the possibility of a judicial statement that would negate the statements already made by the courts in the Board's favor. For example, there was the statement of the Tenth Circuit Court of Appeals regarding Continental's attempt to enjoin the administrative proceeding that had been ordered by the Board. The issue of the Board's statutory authority to require adequate capital was not directly raised; the question was whether the Hearing Examiner could go forward with the hearing. However, the language of the court opinion confirmed the Board's authority to inquire into a bank's capital and to take such steps as necessary. Furthermore, court decisions rendered in this case had gone a long way toward offsetting the views expressed in the Hearing Examiner's Report and Recommended Decision, especially the alleged violation of

9/14/62

-26-

due process of law. While the issue was not directly raised or discussed, every opportunity was available for the courts to take action to require termination of the proceeding. However, the courts regarded the proceeding as a reasonable means of determining the issues that the Board had sought to prove.

Another question was whether the Board should accept an offer of settlement that was clearly aimed at a level of capital wholly inadequate in the circumstances. It definitely should not. If the Board should conclude that this kind of an offer was before it, the Board would have little choice but to go forward and take steps designed to achieve the goal it had set out to obtain. In Mr. O'Connell's judgment, however, while Mr. Sullivan's proposal would not produce an optimum capital position, it would bring the bank sufficiently within range of the median as to constitute a reasonable basis for settlement. In saying this, he again had in mind what might result if the Board continued with the proceeding.

A further question was whether it would be to the Board's advantage to continue the proceeding for the central purpose of obtaining a definition of its authority. Admittedly, the rather severe statement by Hearing Examiner Woodall was a part of the record. There was no assurance, however, that this could be fully rectified. Conceivably, Hearing Examiner Doyle would issue a report and recommended decision that would offset certain of the

9/14/62

-27-

propositions stated by Hearing Examiner Woodall. However, Mr. Doyle would not have before him a number of the issues commented on by Mr. Woodall; they would not be brought back before him. Thus, those issues might not be considered by Mr. Doyle as appropriately the subject of comment.

As to the methods of determining capital adequacy, the Board had already rejected the Hearing Examiner's rejection of various formulas by issuing its 1960 order and statement, in which the Board set forth what it felt was a reasonable approach to the determination of capital adequacy; that is, the ratios and formulas supplemented by discretionary judgments such as described by Messrs. Powell and Solomon.

A further question was whether acceptance of the Sullivan proposal would be regarded by other banks and by the public as a sign of weakness in the Board's position. In Mr. O'Connell's judgment it would not. One could not be certain that other banks and the public would not jump to the conclusion that the Board had given in on the matter; nor, if the hearing went forward, could it be guaranteed that press reports of it might not appear to the bank's advantage. However, there was sufficient basis presented by this proposal whereby any inquiring mind could accept the reasons why the proceeding was terminated by acceptance of the offer. For one thing, at the time of the Board's 1960 order demanding an increase in capital of \$1.5 million, the bank's capital was about \$5 million. Based on

9/14/62

-28-

the June 30, 1962, condition report, and after giving effect to Mr. Sullivan's proposal, the bank's capital would be almost \$6.5 million.

Mr. O'Connell went on to make the comment that he had received from Messrs. Swan, Ahlf, and Galvin of the San Francisco Bank indications to the effect that they were impressed with the sincerity and honesty of purpose of Mr. Sullivan. They sensed a divorcement from the type of bank management implicit in former President Cosgriff's reign. The latter's management of the bank was identified closely with the capital adequacy problem; Mr. Cosgriff's management tactics had permeated the entire hearing record. Admittedly, Mr. Sullivan could not be completely divorced from this record. However, to the extent that the Board accepted as legitimate and sincere Mr. Sullivan's offer of settlement, including his statement of intent as to the future conduct of the bank's operations, to the same extent would Mr. Cosgriff's attitude in operating the bank seem of less importance.

Mr. O'Connell also said that he had discussed with Mr. Sullivan in general terms the type of statement that might be issued by the Board if Mr. Sullivan's offer should be accepted as a basis for terminating the proceeding, indicating that the views stated reflected his (Mr. O'Connell's) judgment and that the matter had not been discussed with the Board. A statement such as he had



9/14/62

-29-

outlined might refer to the present capital position of the bank, the nature of the capital proposal made by the bank, and the apparently sincere intent of the management of the bank to conduct a safe banking operation in the future; and it might indicate that these bases were deemed sufficient by the Board to terminate the proceeding. Mr. O'Connell said both Mr. Sullivan and Mr. Billings had indicated agreement with this type of statement and expressed their intent not to separate the Board and the bank in the eyes of the press or the public.

Mr. O'Connell concluded by saying that in general the points made by Mr. Powell had a good deal of force as arguments for going forward with the proceeding. However, that line of reasoning looked toward a scheme of litigation. Mr. O'Connell felt there was much to be said for considering a termination of the proceeding on the basis of the settlement offered. Although not wholly adequate, he thought the proposal was reasonably adequate. On balance, he would suggest careful consideration of the proposal.

Governor Shepardson inquired whether the Division of Examinations had given consideration to the action taken earlier this year with respect to the salaries of the officers of Continental. In reply, Mr. Solomon said he understood Mr. Sullivan had told President Swan that the bank proposed, in making these adjustments, to eliminate bonuses to its officers. In effect, the bonuses

9/14/62

-30-

formerly given had been a part of the officers' salaries. Because of the bank's cash method of bookkeeping, the giving of such bonuses made the bank look better at one season of the year than another. The salary payments would be spread throughout the year rather than lumped at the end of the year. Mr. O'Connell indicated that Mr. Sullivan had spoken to him along the same lines.

Governor Mitchell then raised with Board Counsel certain questions with respect to the procedure that would be anticipated in connection with the scheduled show cause hearing. The replies indicated that in an effort to save time, and in view of the expressed desire of Continental, an agreement might be worked out with Counsel for Continental for the stipulation of certain statistical evidence, including reports of condition, earnings and dividend reports, and--without admitting agreement with the conclusions--certain capital ratios and formulas. A complete stipulation would mean that the opinions of expert supervisory witnesses would not be included in the record, and the Hearing Examiner would simply certify to the Board the evidence in the record. Then Counsel would analyze the evidence of record in a brief. In Mr. Powell's opinion, due to the expert opinions already in the record, the Board would not need further testimony of that kind in order to reach a decision. On the other hand, the further expert opinions would be interesting. His preference would be to

9/14/62

-31-

stipulate the basic statistical data, but to put witnesses on the stand to express their opinions with respect thereto.

Governor Mitchell inquired of Mr. O'Connell whether he had discussed with Mr. Sullivan the possibility of the bank's agreeing to increase retained earnings over the next four or five years. Mr. O'Connell replied that Mr. Sullivan felt he had gone about as far as he could in proposing an amount of additional capital stock that would be sold for cash. This was in contrast to starting with a lesser amount that might have been regarded as a "talking" offer. Having gone as far as he did in this regard, Mr. Sullivan did not feel that he could promise to retain a specific amount of earnings over a period of years. Therefore, he did not insert in his letter any specific figure. Mr. O'Connell said Mr. Sullivan stated quite vigorously that his letter reflected his best judgment as to what could be done by way of providing additional capital stock and giving general assurance of retention of earnings.

Question was raised at this point as to the ability of Continental to sell a greater amount of additional capital stock than proposed by Mr. Sullivan, with particular reference to the ability of the principal stockholders to purchase such stock. On this point, Mr. Stephenson said that although initial analysis might indicate an ability on the part of the Cosgriff family to purchase a considerable amount of stock, there were certain factors which might

9/14/62

-32-

diminish that ability, including the fact that a substantial part of the net worth was tied up in estates. Mr. O'Connell indicated that this appraisal coincided with statements made to him by Mr. Sullivan, executor of the estates of Mr. Cosgriff and Mr. Cosgriff's mother, who said that the proposal made by him reflected the ultimate ability to purchase stock, working within the confines of the two estates as they stood. Mr. Powell maintained, on the other hand, that there was certainly an indication that as much as \$590 million of additional stock could be purchased readily by the Cosgriff family on the basis of the net worth statements of Mr. Cosgriff and his mother at the time of death.

Governor Shepardson inquired as to the procedure that would be contemplated if the Board decided to accept the Sullivan proposal. Mr. O'Connell replied that he assumed the Board's intention would be communicated to Mr. Sullivan. Thereafter, arrangements would be made for the formal submission of the proposal to the Board by the bank. Then the fact of the formal proposal and its acceptance by the Board should become a part of the record of the case. To do this, the show cause hearing would be opened at a given date. The Hearing Examiner would have the posture of the matter identified to him by Counsel for the Board and the bank, following which an order would be issued closing the hearing and terminating the proceeding.

9/14/62

-33-

Governor King inquired whether there had been any formal charges of improper influence by Continental against Hearing Examiner Woodall, and Mr. Powell replied that there had never been any formal charges or investigation. In any event, this factor was not material to the Board's deliberations today. Governor King indicated that, in the circumstances, he questioned whether it was appropriate for allegations in this regard to have been mentioned at this meeting. In reply to a question, he was informed by Board Counsel that the minutes of this meeting would not be a part of the record of the case in the event of judicial review.

In a further question with regard to procedure, Governor Shepardson inquired whether, if the Board were inclined to accept the tentative offer of settlement, further evidence would need to be introduced on the capital position of Continental. He asked whether there could not simply be an account of the present capital position of Continental, the proposal to increase capital and what would be accomplished by it, and an indication of the Board's acceptance. Mr. O'Connell replied that he felt this would be sufficient as a basis for termination of the proceeding. Governor Shepardson went on to suggest that if the show cause hearing were to proceed to the point of putting on witnesses, who would state their views as to the bank's capital requirements, a subsequent decision by the Board--as the result of further deliberation--to accept the



9/14/62

-34-

bank's proposal for settlement might leave the matter in a more confused posture from the standpoint of public discussion. Mr. O'Connell replied that if the hearing should proceed in such fashion, he supposed it would be on the basis that there was no offer outstanding. The hearing would be held on the basis that the Board had rejected the proposal. Governor Shepardson noted, however, that he assumed the Board could accept another offer of settlement, if one were made, and Mr. O'Connell confirmed that such an offer could be accepted at any time. Mr. Powell noted that the current offer, if rejected, would not be part of the record of the proceeding; no one would know that an offer had been made. If Mr. Sullivan should later make even the same offer a second time, that would be a new offer as far as the record of the proceeding was concerned.

Governor Balderston referred back to Mr. O'Connell's earlier comments about the nature of a possible announcement if the offer of settlement were accepted, and Mr. O'Connell assured him that nothing had been put in writing in this regard. He had simply suggested to Mr. Sullivan that in his personal opinion a statement might be made along the lines of defining the purpose for which the capital adequacy proceeding was instituted, citing the capital position of the bank at this time, stating what had been proposed by the bank, and indicating that on such basis the Board felt justified in terminating the proceeding.

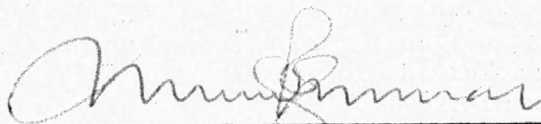
9/14/62

-35-

Chairman Martin then inquired whether there were further questions. There being none, he suggested that the Continental matter be discussed further by the Board at its meeting on Monday, September 17, and it was agreed that this procedure would be followed.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board a letter to the Federal Reserve Bank of New York (attached Item No. 9) approving the reappointment of N. Dennis Stafford, Jr., as assistant examiner.



Secretary

Item No. 1  
9/14/62

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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

The Gallatin Company, Inc.,  
70 Broadway,  
New York 15, New York.

Gentlemen:

In accordance with the request made by Mr. R. P. Furey, Vice President, Manufacturers Hanover Trust Company, on behalf of your Company and on the basis of the information furnished in his letter dated August 17, 1962, transmitted through the Federal Reserve Bank of New York, the Board of Governors grants its consent to The Gallatin Company, Inc. to change the location of its Principal Office from 70 Broadway, New York, New York, to 350 Park Avenue, New York 22, New York. The location of the Principal Office may not be changed, after removal, without the prior approval of the Board of Governors.

Please advise the Board of Governors in writing, through the Federal Reserve Bank of New York, when the Company has moved to the new location.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,  
Assistant Secretary.

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



ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962.

Board of Directors,  
Provident Tradesmens Bank and  
Trust Company,  
Philadelphia, Pennsylvania.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the change in location of a branch by Provident Tradesmens Bank and Trust Company, Philadelphia, Pennsylvania, from Righters Mill Road near Youngsford Road to Merion Square Shopping Center on the western corner of Righters Mill Road and Youngsford Road--both locations in Gladwyne, Lower Merion Township, Montgomery County, Pennsylvania. This approval is granted provided the branch is established by May 10, 1963.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,  
Assistant Secretary.

Item No. 3  
9/14/62**TELEGRAM**  
LEASED WIRE SERVICEBOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON

September 14, 1962

Bryan - Atlanta

The Board will interpose no objection to proceeding with the West addition to the Atlanta head office building on the basis of the plans outlined in Mr. Patterson's letter of August 9, 1962, and the architects' drawings submitted with the letter.

(Signed) Merritt Sherman

SHERMAN



Item No. 4  
9/14/62

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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Board of Directors,  
Security Bank & Trust Company of Bozeman,  
Bozeman, Montana.

Gentlemen:

The Board of Governors of the Federal Reserve System approves, under the provisions of Section 24A of the Federal Reserve Act, an investment in bank premises by Security Bank & Trust Company of Bozeman, Bozeman, Montana, of \$193,170.69. The amount approved includes \$163,170.69 representing the bank's investment in leasehold improvements, prior to amortization, and \$30,000 representing the bank's acquisition cost to expand parking facilities.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,  
Assistant Secretary.

Item No. 5  
9/14/62

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



ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Mr. H. G. McConnell, Vice President  
and Secretary,  
Federal Reserve Bank of Minneapolis,  
Minneapolis 2, Minnesota.

Dear Mr. McConnell:

Reference is made to your letter of July 27, 1962, submitting the request of Security Bank & Trust Company of Bozeman, Bozeman, Montana, for the Board's approval, pursuant to Section 24A of the Federal Reserve Act (12 USC 371d), of an investment in bank premises.

The enclosed letter, to be forwarded to the applicant bank, approves an investment of \$193,170.69, representing the investment by the State member bank in leasehold improvements and a parking lot.

It is noted that Security Building, Inc., which incurred indebtedness of \$500,000 to erect the bank building, is an "affiliate" of the State member bank, under Section 2(b)(2) of the Banking Act of 1933 (12 USC 211a), by reason of common stock ownership, but that the bank itself has no investment in the company. Although Section 24A requires "the amount of any indebtedness" of an affiliate holding the bank premises to be taken into account in determining whether an investment in bank premises by the bank requires Board approval, the statute does not ordinarily require approval for the incurring of such indebtedness by the affiliate. However, in the case of a bank-premises company that is a majority-owned subsidiary of the bank, an indebtedness incurred by such company would be incurred indirectly by the bank itself and therefore would require Board approval. Attention is directed to the Board's letter of November 9, 1956 (F.R.L.S.#6852), dealing with indebtedness of an affiliate owned by the bank.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.

Enclosure

Item No. 6  
9/14/62BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON 25, D. C.ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Mr. James Ahlf, Chief Examiner,  
Federal Reserve Bank of San Francisco,  
San Francisco 20, California.

Dear Mr. Ahlf:

This refers to your letter of August 24 inquiring whether the Board would require republication of the March 26 and June 30, 1962, reports of condition of Fidelity Bank, Beverly Hills, California. It is understood that (1) the member bank sold to a savings and loan association under repurchase agreements about \$1,153,079 of real estate mortgages all of which were outstanding at the June 30 call date and some of which were outstanding at March 26; (2) the March 26 and June 30 reports of condition of Fidelity Bank, Beverly Hills, California, as submitted to your Bank, and presumably as published pursuant to existing regulations, show no amount against item 21, Rediscunts and Other Liabilities for Borrowed Money; and (3) this misreporting was discovered incident to the examination of the member bank as of May 14, 1962, at which time the bank was advised that, in accordance with existing instructions for preparing reports of condition of State member banks, its liability under such agreements to repurchase should be reported as borrowings.

The Board concurs that under the instructions for the preparation of reports of condition the amounts should have been reported and published in loans and in borrowings. In view of the sizable amount involved, the republication of the bank's reports of condition submitted after it had been advised as to correct reporting would be clearly justified; but inasmuch as republication of the June 30 report at this late date would probably serve no useful purpose, it need not be required.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. James Ahlf

-2-

It is suggested that you inform the bank in writing how the real estate loans and borrowings items should have been reported, and should be reported if any portion of the borrowing is outstanding when the next call is made. After this has been done, your Bank is authorized to require republication, without referral to the Board, of any report of condition submitted by the Fidelity Bank within the next two years which is incorrect in these matters.

Very truly yours,

**(Signed) Merritt Sherman**Merritt Sherman,  
Secretary.



Item No. 7  
9/14/62

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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Board of Directors,  
Wells Fargo Bank,  
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to September 20, 1963, the time within which Wells Fargo Bank may establish a branch in the vicinity of the intersection of Winding Way and Manzanita Avenue, in an unincorporated area of Sacramento County, California.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,  
Assistant Secretary.

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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Mr. W. D. Fulton, Chairman,  
Conference of Presidents,  
c/o Federal Reserve Bank of Cleveland,  
Cleveland 1, Ohio.

Dear Mr. Fulton:

The Board notes without objection the recommendations of the Subcommittee on Electronics as approved by the Conference of Presidents on September 10, 1962, that the services of Stanford Research Institute be engaged to appraise the economic and operational feasibility of mechanizing the paper currency sorting and counting operations of the Federal Reserve Banks. It is understood that the contract will be executed by the Federal Reserve Bank of New York and the cost, not to exceed \$33,000, prorated among all Federal Reserve Banks.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.



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

Item No. 9  
9/14/62

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 14, 1962

Mr. John F. Pierce, Chief Examiner,  
Federal Reserve Bank of New York,  
New York 45, New York.

Dear Mr. Pierce:

In accordance with the request contained in your letter of September 10, 1962, the Board approves the reappointment of N. Dennis Stafford, Jr., as an assistant examiner for the Federal Reserve Bank of New York. Please advise the effective date of the reappointment.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,  
Assistant Secretary.