

Minutes of the Board of Governors of the Federal Reserve System on Monday, April 1, 1963. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Smith, Assistant Director, Division of Examinations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Thompson, Assistant Director, Division of Examinations
Mr. Mattras, General Assistant, Office of the Secretary

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

Item No.

Letter to the Federal Reserve Bank of Richmond regarding allocation of the cost of property purchased by the Bank on February 5, 1963, and the rate of depreciation on the buildings. (Purchase of the property was authorized by the Board on January 15, 1963.)

1

4/1/63

-2-

	<u>Item No.</u>
Letter to the Federal Reserve Bank of St. Louis noting without objection its intention to acquire certain electronic check processing equipment for the head office.	2
Letter to United California Bank, Los Angeles, California, approving the establishment of a branch at Mission Center Road and U. S. Highway 80, San Diego.	3
Letter to Counsel for Building Leasing Corporation, Kansas City, Missouri, granting a determination exempting the corporation from all holding company affiliate requirements except those contained in section 23A of the Federal Reserve Act.	4

In connection with Item No. 3, it was reported that a letter had been drafted to United California Bank with regard to the bank's current study of its capital needs, as requested at the Board meetings on March 20 and 22, 1963, and that Governor Robertson had suggested certain modifications in the proposed letter. The two drafts were read to the Board; the principal distinction between them was that the language suggested by Governor Robertson went somewhat further in indicating a generally unfavorable Board attitude toward the use of debentures as a means of providing bank capital.

After discussion, the letter suggested by Governor Robertson was approved unanimously. A copy is attached to these minutes as Item No. 5.

Messrs. Hooff, Daniels, and Thompson then withdrew from the meeting.

4/1/63

-3-

Loss of securities (Items 6, 7, and 8). A report had been drafted, in accordance with the understanding at the meeting on March 29, 1963, with regard to the loss of certain Treasury securities at the Federal Reserve Bank of San Francisco. The report was prepared in response to the request in a letter dated March 28, 1963, from Congressman Fascell, Chairman of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations.

Governor Robertson reported that during the afternoon of March 29 he received a telephone call from Congressman Patman, Chairman of the House Banking and Currency Committee, requesting a report not later than today on the loss, along with the minutes of the Board of Directors of the San Francisco Bank for 1962. Later, a request for a report on the incident was also received from Congressman Talcott of California, a member of the House Banking and Currency Committee.

Governor Robertson stated that Chairman Patman and Congressman Talcott had been advised of the report being prepared for Chairman Fascell and had been told that their requests would be presented to the Board. In addition, Congressman Patman had been advised that he would receive the minutes of the Board of Directors of the San Francisco Bank; this advice was given to him following telephone conversation with President Swan, who had obtained the concurrence of directors of the San Francisco Reserve Bank and stated that he was sending to the Board, for transmittal, copies of the minutes of the Board of Directors, the

4/1/63

-4-

Executive Committee, and the Audit Review Committee. With the minutes of the Audit Review Committee, it seemed appropriate to include copies of certain reports by the General Auditor--referred to in the minutes of the Audit Review Committee--regarding the disappearance of the securities.

Secretary's Note: A copy of the letter sent to Chairman Patman on April 1, 1963, transmitting copies of the aforementioned minutes and reports is attached as Item No. 6.

The draft report was then discussed at some length and certain suggestions were made in the interest of clarification and providing a fully explanatory document. It was noted, in this connection, that the Division of Examinations had been in touch with President Swan in the course of preparing the draft report and that several technical suggestions by the Reserve Bank had been incorporated.

Part of the discussion dealt with what might appropriately be said in the report about the performance of the Reserve Banks in handling the safekeeping of securities, and it was suggested that the records available at the Board's offices be supplemented by a check with the General Auditors of the respective Reserve Banks in order to insure the accuracy of this portion of the report. It was also suggested that the General Auditors be asked to describe what changes, if any, had been made in the security and control procedures of the respective Reserve Banks following disclosure to the Banks last summer of the loss of securities at San Francisco.

4/1/63

-5-

Subject to the incorporation in the report of such modifications as might appear desirable following further staff study in the light of the comments and suggestions made at this meeting, it was understood that copies of the report would be furnished to Congressmen Fascell, Patman, and Talcott. It was also understood that copies would be sent to the President and General Auditor of each Reserve Bank as a matter of information.

Since the report on the San Francisco incident made reference to the loss of a Treasury certificate of indebtedness at the Federal Reserve Bank of Richmond, it was agreed that the Secretary of the Board should inform President Wayne before the report was transmitted, with an opportunity for him to do such checking with the directors of the Richmond Bank as might seem necessary or desirable.

Secretary's Note: Copies of the report were transmitted later in the day to Congressmen Fascell, Patman, and Talcott. A copy of the letter of transmittal to Congressman Fascell is attached as Item No. 7; the letters to Congressmen Patman and Talcott were similar. A copy of the report on the San Francisco incident, as transmitted, is attached as Item No. 8. On April 4, a copy of the report was also sent to Congressman Kilburn of New York, a member of the House Banking and Currency Committee, at his request; this was reported to the Board by the Secretary at the meeting on April 5, 1963.

Governor Robertson noted that Congressman Patman had also asked, on Friday, March 29, to be furnished a transcript of the press conference in San Francisco on March 27 at which President Swan read a

4/1/63

-6-

statement concerning the loss of the securities and responded to questions from the press. Inquiry of President Swan revealed that no transcript was made of the press conference. This information was furnished to Congressman Patman, and he was sent a copy of the statement read at the press conference by President Swan.

The meeting then adjourned.

Secretary's Notes: On March 29, 1963, Governor Robertson, acting in the absence of Governor Shepardson, approved on behalf of the Board a telegram to the Federal Reserve Bank of Minneapolis (attached Item No. 9) approving the appointment of David J. Freeberg as assistant examiner.

Pursuant to the recommendation contained in a memorandum from the Division of Examinations, Governor Shepardson today approved on behalf of the Board acceptance of the resignation of Richard B. Friedman, Assistant Federal Reserve Examiner in that Division, effective at the close of business April 6, 1963.


Secretary

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

Item No. 1
4/1/63



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1963

Mr. Edward A. Wayne, President,
Federal Reserve Bank of Richmond,
Richmond 13, Virginia.

Dear Mr. Wayne:

This refers to your letter of March 11, 1963, about the allocation of the cost of the property purchased by the Federal Reserve Bank of Richmond on February 5, 1963, and the rate of depreciation on the buildings.

It is noted that, on the basis of a recent appraisal, 55 per cent of the purchase price was allocated to Land and 45 per cent to Buildings, and that no amount was allocated to Fixed Machinery and Equipment.

It is also noted that the appraisal indicated the larger of the two buildings acquired has a remaining economic life of 10 years, and the smaller, a remaining economic life of 20 years. In view of this opinion and the statement in your letter that it would not be feasible to dispose of or remove one of the two buildings apart from the other, the Board approves considering the two buildings as one for purposes of depreciation and establishing an annual depreciation rate of 10 per cent on the combined gross book value.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 2
4/1/63



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1963.

Mr. Harry A. Shuford, President,
Federal Reserve Bank of St. Louis,
St. Louis 66, Missouri.

Dear Mr. Shuford:

The Board has noted without objection the intent of the St. Louis Reserve Bank, as outlined in your letter of March 18, 1963, to acquire for the Head Office in the first quarter of 1964 an IBM 1420 check processing system at a monthly rental of \$6,245 and supporting low-speed encoding equipment at a monthly rental of \$3,349.50.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 3
4/1/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1963.



Board of Directors,
United California Bank,
Los Angeles, California.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment of a branch by United California Bank in the vicinity of the Mission Valley Center at Mission Center Road and U. S. Highway 80, San Diego, California, provided the branch is established within eighteen months from the date of this letter.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon
Assistant Secretary

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)

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

Item No. 4
4/1/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1963



Granoff, Levy and Craig,
916 Walnut Street Building,
Kansas City 6, Missouri.

Attention Bernard D. Craig, Esq.,
Counsel for Building Leasing Corporation

Gentlemen:

This refers to your letter of March 27, 1963, requesting a determination by the Board of Governors of the Federal Reserve System as to the status of Building Leasing Corporation as a holding company affiliate.

From the information submitted, the Board understands that Building Leasing Corporation and its affiliated companies are engaged in the business of building and leasing commercial buildings; that such Corporation will become a holding company affiliate if and when it acquires a majority of the shares of stock of Civic Plaza National Bank of Kansas City, Kansas City, Missouri, and that bank opens for business; and that such Corporation does not, directly or indirectly, own or control any stock of, or manage or control any other banking institution.

In view of these facts, the Board has determined that Building Leasing Corporation will not be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies within the meaning of section 2(c) of the Banking Act of 1933 (12 U.S.C. 221a); and, accordingly, such Corporation will not be deemed to be a holding company affiliate except for the purposes of section 23A of the Federal Reserve Act and will not need a voting permit from the Board of Governors in order to vote the bank stock which it proposes to acquire.

If, however, the facts should at any time indicate that Building Leasing Corporation might be deemed to be so engaged, this matter should again be submitted to the Board. The Board reserves

Granoff, Levy and Craig

-2-

the right to rescind this determination and make further determination of this matter at any time on the basis of the then existing facts. Particularly, should future acquisitions by or activities of such Corporation result in its attaining a position whereby the Board may deem desirable a determination that such Corporation is engaged as a business in the holding of bank stock, or the managing or controlling of banks, the determination herein granted may be rescinded.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 5
4/1/63



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1963

Mr. Frank L. King,
Chairman of the Board,
United California Bank,
Los Angeles, California.

Dear Mr. King:

Your letter of March 5, 1963, indicating that a study of United California Bank's capital needs was in progress has been brought to the attention of the Board, which has given it careful consideration in the light of the Board's letter to your bank on February 13. The Board has requested me to express its appreciation for your letter and to urge the utmost expedition in completing the study.

It also wanted me to call to your attention its special interest in your conclusions with respect to the use of debentures, in view of its generally unfavorable attitude with respect to the use of that means of providing bank capital.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 6
4/1/63

OFFICE OF THE CHAIRMAN

April 1, 1963

The Honorable Wright Patman,
Chairman,
Banking and Currency Committee,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

In accordance with your telephone request to Governor Robertson last Friday and Mr. Swan's letter to you of that date, there are enclosed copies of the minutes of the meetings of the Board of Directors of the Federal Reserve Bank of San Francisco during the calendar year 1962; minutes of the meetings of the Executive Committee of the San Francisco Bank held during 1962; and minutes of the meetings of the Audit Review Committee of the San Francisco Bank held during the year 1962. Accompanying the minutes of the meetings of the Audit Review Committee are special reports from the General Auditor of that Bank dated August 15, 1962 and November 13, 1962 regarding the disappearance of certain securities from the vaults of the San Francisco Bank.

As you know, the minutes of the meetings of the directors, the Executive Committee, and the Audit Review Committee are generally regarded as confidential. If your Committee should decide that public release of some portions of these minutes would be in the public interest, it would be appreciated if before releasing them there would be an opportunity given for either this Board or the San Francisco Bank to review in advance the portions that you believe should be released.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

Item No. 7
4/1/63BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

April 1, 1963.

The Honorable Dante B. Fascell,
Chairman,
Legal and Monetary Affairs Subcommittee
of the Committee on Government Operations,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

As requested in your letter of March 28, 1963, I am enclosing a copy of a report on the apparent inadvertent destruction of certain Treasury certificates of indebtedness at the Federal Reserve Bank of San Francisco in the spring or summer of 1962.

This report is also being furnished to the Honorable Wright Patman, Chairman of the Banking and Currency Committee, and to the Honorable Burt L. Talcott, in response to their requests.

No monetary loss has been suffered in connection with the disappearance of these certificates of indebtedness and, as discussed more fully in the report, the investigations of the incident lead to the conclusions that the certificates were destroyed by burning and that no monetary loss will be suffered by any party.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure

APPARENT INADVERTENT DESTRUCTION
OF CERTAIN TREASURY CERTIFICATES OF INDEBTEDNESS
AT THE FEDERAL RESERVE BANK OF SAN FRANCISCO

Summary

Twelve United States Certificates of Indebtedness aggregating \$7.5 million disappeared from the vault of the head office of the Federal Reserve Bank of San Francisco some time between May 29 and August 8, 1962. The certificates were series B-1963 with interest at 3-1/4%, dated May 15, 1962, and due May 15, 1963, and comprised 7 for \$1 million each (serial numbers 411 through 417) and 5 for \$100,000 each (serial numbers 2524 through 2528). Attached to each certificate were two interest coupons covering two semi-annual interest payments and bearing corresponding serial numbers.

The Board of Directors of the Reserve Bank, the Board of Governors of the Federal Reserve System, the Treasury Department, and the Secret Service were promptly notified, and exhaustive investigations were made by all concerned. There has been absolutely no evidence to indicate that the certificates were intentionally removed from the Bank's vault.

Coupons attached to the certificates were due November 15, 1962, but none was presented for payment. This strengthens the conclusion, previously indicated by other evidence developed in the course of the investigations, that the certificates were accidentally destroyed and there will be no monetary loss.

In fact, a review of the past ten years shows that the Reserve Banks have had custody of millions of pieces of marketable Government securities aggregating hundreds of billions of dollars without any resulting financial loss.

Events Preceding Investigations

The Federal Reserve Bank, acting as fiscal agent of the Treasury Department, issued the certificates involved to a member bank on May 15, 1962, in accordance with the member bank's subscription to the Treasury's offering. Pursuant to instructions of the member bank, the certificates upon issue remained in the Reserve Bank's vault to be held as part of the collateral pledged by the member bank for loans, discounts, and advances. They were enclosed in an envelope together with other securities of various issues which the member bank had previously pledged as collateral for the same purpose. The envelopes used in the vault for holding securities have linear rulings on their face for recording receipts and withdrawals and the current balance of the contents.

On May 29, at the request of the member bank, these certificates were withdrawn from collateral for loans, discounts, and advances and transferred into Treasury tax and loan collateral. Evidence indicates they were withdrawn from the envelope holding collateral for loans, discounts, and advances and transferred into the envelope holding collateral for the member bank's Treasury tax and loan account, as the serial numbers of the certificates were shown on both the withdrawal and deposit entries.

On May 31, it became necessary to make two withdrawals from the member bank's Treasury tax and loan collateral to consummate two delivery orders received from the member bank. These withdrawals consisted of \$1 million and \$5 million Treasury notes G-1962.

-3-

Inasmuch as the recording space on the face of the envelope which contained the Treasury tax and loan collateral was completely filled, it became necessary to start a new envelope to reflect these withdrawals. This necessitated the transfer of all the securities pledged by the member bank for its tax and loan account -- including the certificates in question -- from the old to the new envelope. This would have involved the transfer of 157 pieces of collateral in the amount of \$49,520,000. The old envelope was then discarded.

On August 8, the member bank instructed that the certificates involved be withdrawn from its Treasury tax and loan collateral and delivery made through the wire facilities of the Federal Reserve System to a securities dealer in New York City. (This procedure would have involved the return of the certificates to the general stock held for the Treasury Department at the Federal Reserve Bank of San Francisco and the issuance of an equivalent amount from the general stock held for the Treasury at the Federal Reserve Bank of New York.) The vault custodians received the instructions at about 11:00 a.m. and found that the particular certificates were not in the envelope which contained the member bank's Treasury tax and loan collateral. They made a preliminary check in an effort to locate the certificates on the possibility that they might have been misfiled. The supervising officers and the General Auditor of the Reserve Bank were notified about 12:15 p.m. that the certificates could not be located.

-4-

To discharge its obligation to the member bank, the Federal Reserve Bank of San Francisco completed the transaction in the regular manner, except that it was unable to restore to the general stock of the Treasury Department held by it certificates equivalent to those issued by the New York Reserve Bank. The Treasury Department is fully aware of this action.

Investigations

Immediately upon being notified that the certificates were unaccounted for, the General Auditor commenced a complete audit of all securities held in the vault at the head office of the Reserve Bank. The audit included not only a physical count of the securities in the vault to check them against the respective ledger controls, but also a thorough inspection of the physical premises, an inspection of the trash accumulation which is ordinarily retained for one month before burning (the trash then on hand dated back to July 11), and a review and analysis of the records of securities transactions in an effort to determine that the particular securities (as identified by the serial numbers) had not been delivered out of the vault in connection with any other transaction.

On Friday, August 10, 1962, when it became clear that the certificates could not be located the Board of Directors of the Reserve Bank, the Board of Governors of the Federal Reserve System, the Treasury Department, and the United States Secret Service were all notified.

-5-

The Board of Governors promptly sent to San Francisco the Assistant Director of its Division of Examinations who has responsibility for examinations of the Federal Reserve Banks to make an on-the-scene review of the circumstances of the matter and the audit and other investigative procedures employed. He arrived at San Francisco on Sunday, August 12, and remained until Thursday, August 16. During this period, he reviewed the scope of the investigation made by the internal auditing staff and the procedures employed, reviewed the Reserve Bank's established procedures for the handling and safekeeping of securities, observed the execution of such procedures, and discussed various aspects of the case with officers of the Bank who were familiar with the matter, the General Auditor, and the vault custodians and other personnel who handle securities. From these reviews and discussions, it appeared that all possibilities that might explain the disappearance of the certificates had been considered and investigated.

The United States Secret Service made its own investigation of the matter, as further referred to below.

Investigative Conclusions

The following excerpt is quoted from the Secret Service's report dated October 10, 1962:

"The investigation disclosed no evidence indicating the twelve missing Certificates of Indebtedness were intentionally removed from the main vault at the Federal Reserve Bank. Seventeen present and former employees given polygraph examinations, and no guilty knowledge established.

-6-

"In view of the facts developed during the investigation and the results of the polygraph examination it appears probable that the certificates were inadvertently left in the used envelope when the other material was transferred, and destroyed when instructions concerning the handling of the used envelopes and waste material were not followed to the letter."

The finding of the Secret Service accords with the conclusions of the other investigations, namely, that the certificates were inadvertently left in the envelope discarded when the transfer of May 31, previously described, was consummated, and were subsequently incinerated with waste material.

In describing the circumstances which support this conclusion the physical dimensions of the vault envelope and of the certificates seem significant. The envelope in which the certificates were contained was of heavy stock, 12 inches high by 16-1/4 inches wide. The certificates were 4-1/2 inches high by 11 inches wide. Other types of marketable Treasury issues, particularly notes and bonds, are considerably larger in size, the top to bottom dimensions being not less than 6 inches. Certificates of indebtedness of this type customarily were filed as the last item in the envelope, behind the various other kinds of collateral that might have been enclosed. As previously mentioned, the Treasury tax and loan collateral pledged by the member

-7-

bank which owned the missing certificates included more than 100 pieces of other issues. In view of the small size of the certificates of indebtedness relative to the other items in the envelope it is believed that in transferring the holdings from the old to the new envelope on May 31, 1962, the custodian could have failed to grasp the smaller certificates in his fingers, and that they therefore remained in the old envelope subsequently incinerated with other waste material. (Trash is burned on the premises of the Reserve Bank and by its employees.)

Other Precautionary Measures

On August 13, 1962, the Treasury Department furnished all Federal Reserve Banks a list of the serial numbers of the missing certificates and requested that they be on the lookout for presentation of these certificates (for exchange or other purpose). All Reserve Banks and Branches also made a check of the certificates of indebtedness held in their custody to ascertain that the missing items had not come into their possession.

On October 16, 1962, the Treasury Department requested all Federal Reserve Banks and Branches to watch out for interest coupons from the missing certificates covering interest due November 15, 1962, in case they were presented for payment. The Treasury Department itself has, of course, alerted its employees to inspect certificates or coupons of the B-1963 issue received by it for processing to

determine whether they include any of the serial numbers of those that disappeared at the Reserve Bank. No interest coupons from the missing certificates have been presented for payment.

No one -- neither the member bank involved, the Federal Reserve Bank of San Francisco, nor the Treasury Department -- has sustained any financial loss. Furthermore, there is no possibility of financial loss except in the unlikely event that one of these certificates or coupons is presented for payment; even then, the chances of loss would depend on the circumstances under which presentment is made.

Security and Control Procedures

The investigations made in connection with the disappearance of the certificates included a careful review of the Reserve Bank's established procedures for the handling and safekeeping of securities. Such procedures appeared to be basically sound, with adequate internal control provisions. It might be helpful to summarize some of these procedures by way of illustration.

The approaches to all restricted areas, including the vault, are controlled by armed guards at all times the vault is open. To gain admittance to such an area a person must present proper credentials or otherwise be recognized by the guard as one authorized to have access to the area. The door to the vault itself is secured by two combination locks, one combination being held by designated officers and the other by certain other officers and designated senior

employees. It is also controlled by a time device and is electronically tied into the San Francisco Police Department which would be automatically alerted by any tampering with the door. Guards are on duty in the Bank 24 hours a day.

The main vault door remains open during the Bank's regular working hours. However, the entrance to the vault is also secured by a steel grille which is kept locked at all times. An armed guard is stationed at this location while the vault is open and, if a person wishes to enter the vault proper, the guard must unlock the grille door for him.

The interior of the vault is divided into compartments by steel bar partitions. Each compartment door has two combination locks and no person may hold both combinations. The securities in the vault are in the joint custody of two custodians. Men assigned to securities custodies are mature, experienced employees of the highest caliber who have shown judgment and care in other previous assignments. The securities are held in chests or drawers within the large compartments, and each such chest or drawer has two combinations or locks. Each custodian knows only one of the combinations or holds only one of the keys.

Securities that come into or are withdrawn from the vault are received and delivered through a small window in the steel partition. At the time of a receipt, the vault custodians accept the securities from a securities teller and each of them makes a verification of the securities and a receipt is given to the teller. When a withdrawal is made, the securities teller presents a requisition which is

inspected by the vault custodians for proper authorization. A description of the securities and the particular account from which they are to be withdrawn are specified on the requisition. The securities are then withdrawn from the envelope in which they have been held, are verified by count by each custodian, and handed to the securities teller, who in turn makes a verification of the securities and gives a receipt to the custodians before he leaves their presence.

The vault custodians enter all transactions in a vault journal provided for the purpose, and as previously stated, also make appropriate entries on the particular envelopes in which the securities are deposited or from which they are withdrawn.

When securities are initially received in the Bank either via registered mail or by messenger delivery, they are verified by a securities teller who issues a receipt in manifold copies. One copy becomes an advice to accompany the securities when they are placed in the vault and another copy is forwarded to the Fiscal Department for recording in the securities liability ledgers maintained by that department as an independent control. Similarly, on deliveries of securities out of the Reserve Bank, a manifold accounting form is prepared, one copy of which becomes the requisition delivered to the vault custodians as outlined above. Another copy goes to the Fiscal Department to become the basis for an entry in the control ledgers. Each day the balances in the control accounts maintained in the Fiscal Department are verified with the balance totals computed by the vault custodians. In addition the vault custodians are required to

piece-count all securities in their custody and verify against the envelope total once in each 3-month period.

Each Reserve Bank has an internal auditing department which is independent of the operating functions in the Bank. The auditing department makes at least two complete audits of securities holdings each year. In the course of such audits, a detailed count is made of the securities in the vault and statements of the holdings are sent to the respective owners with the request that they check such statements against their records and confirm their accuracy to the auditors. In the course of each audit, the procedures of the department under audit are reviewed and any suggestions for improvement, either in form or execution, are noted and brought to the attention of the Bank's management for appropriate action.

The most recent regular audit of the securities vault of the Federal Reserve Bank of San Francisco prior to August 8, 1962, had been made by the Auditing Department on May 23, 1962, at which time the certificates in question were ascertained to be in the envelope containing the collateral pledged by the member bank for loans, discounts, and advances.

The examining staff of the Board of Governors of the Federal Reserve System also makes a complete examination of every Reserve Bank and Branch each year, and such examination includes a verification of the securities holdings and confirmation with the owners of record, an appraisal of the internal controls, and an observation of employee performance.

-12-

Although not formalized in the Reserve Bank's written manual of procedures, it was the practice for the vault custodians when making transfers of securities between envelopes to verify the securities to the total brought forward from the old envelope and to examine the old envelope to insure that all securities had been removed prior to discarding it. In view of the facts developed in the investigation, the Reserve Bank's manual has been amended to include the following specific instructions:

"When it is necessary to transfer securities to a new security envelope because the posting space on the old envelope is filled or for other reasons, these securities should be counted and recorded by issue and denomination on Form LLM 168 and immediately placed in the new envelope. The total of the securities counted as shown on Form LLM 168 should be proved to the last total appearing on the old envelope, and should then be posted to the new envelope. Form LLM 168 should be filed with the securities in the new envelope and retained until the envelope is discarded as provided herein. The old envelope should be completely slit along the seams, opened and inspected to determine that all securities have been removed, and retained in the securities vault until completion of the next Head Office audit, immediately after which it should be discarded."

In addition, the envelopes used for containing securities now have holes punched in them, so spaced as to provide a visual check that all securities have been removed.

The investigation also indicated that the vault custodians were under pressure from a heavy work load, and that this fact may have contributed to the probable failure to comply with standard procedures in this instance. The Reserve Bank has since reduced the scope of work assigned to the vault custodians.

Performance of Reserve Banks in Safekeeping of Securities

A few figures may give some idea of the size of the Reserve Banks' activities in handling securities in various capacities. At the close of 1962 the total value of negotiable securities held in custody by the Reserve Banks was about \$280 billion. At the head office of the San Francisco Reserve Bank alone it was about \$11 billion. These figures include only the securities held for others; they do not include any assets held for the Reserve Bank's own account.

To cite another example -- in 1962, the issue, redemption, and exchange of negotiable U. S. Government securities by the Reserve Banks as fiscal agents for the Treasury required the handling of more than 10 million pieces with a face value in excess of \$605 billion. This, of course, is only one segment of the total securities operations of the Federal Reserve Banks.

The record of the past ten years shows the Reserve Banks have handled this huge volume of negotiable securities without any financial loss. Moreover, in this period there have been only three instances, including the one at San Francisco, where negotiable securities have disappeared at a Reserve Bank, even without any resulting financial loss.

One was discovered in the course of an audit made as of August 13, 1962, of the head office of the Federal Reserve Bank of

-14-

Richmond. The certificate missing at Richmond was also a Treasury Certificate of Indebtedness, 3-1/4%, Series B-1963, dated May 15, 1962, and due May 15, 1963. It was of \$100,000 denomination and bore serial number 15496. It had also been pledged by the owning bank as Treasury tax and loan collateral. When the certificate could not be located, a new certificate was issued to the pledgor bank, the various parties at interest were notified and both the Board of Governors of the Federal Reserve System and the U. S. Secret Service investigated the case. The investigations tended to indicate that the certificate became mixed with trash which was destroyed, and there was no indication of any breach of trust by any employee. The semi-annual interest coupon due November 15, 1962, was not presented for payment.

The other was a case at the head office of the Federal Reserve Bank of Atlanta which was disclosed in the course of the annual examination of that Bank as of February 19, 1954, by examiners for the Board of Governors. In the verification of the securities held by the Bank on examination date, it was ascertained that the canceled stock of Treasury issues for which the Reserve Bank was accountable to the Treasury Department did not include \$101,000 Certificates of Indebtedness, Series C-1954, dated July 15, 1953, and due March 22, 1954. The missing certificates were further identified as one in the denomination of \$100,000, bearing serial number 5058, and another in the denomination of \$1,000, bearing

-15-

serial number 3440. These securities, according to the records, were retired and canceled in connection with a wire transfer of an equivalent amount through the Federal Reserve Bank of New York. The investigations made at that time indicated that the certificates fell or were accidentally brushed off the desk of the vault custodian or the assistant vault custodian into a trash basket and disposed of as waste paper. They never turned up, and the Treasury Department authorized an adjustment in the Reserve Bank's accountability to it to close the matter.

April 1, 1963.

T E L E G R A M
LEASED WIRE SERVICEBOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTONItem No. 9
4/1/63

March 29, 1963.

MC CONNELL - MINNEAPOLIS

IN ACCORDANCE WITH THE REQUEST CONTAINED IN PRESIDENT
DEMING'S LETTER OF MARCH 27, 1963, THE BOARD APPROVES
THE APPOINTMENT OF DAVID J. FREEBERG AS AN ASSISTANT
EXAMINER FOR THE FEDERAL RESERVE BANK OF MINNEAPOLIS.
PLEASE ADVISE THE EFFECTIVE DATE OF THE APPOINTMENT.

(Signed) ELIZABETH L. CARMICHAEL

CARMICHAEL