FR 609
Rev. 9/61

Minutes for April 2, 1963

To: Members of the Board

From: Office of the Secretary

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

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

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin _____

Gov. Mills _____

Gov. Robertson _____

Gov. Balderston _____

Gov. Shepardson _____

Gov. King _____

Gov. Mitchell _____

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, April 2, 1963. 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. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Noyes, Director, Division of Research and Statistics
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Koch, Associate Director, Division of Research and Statistics
Mr. Holland, Adviser, Division of Research and Statistics
Mr. Conkling, Assistant Director, Division of Bank Operations
Mr. Benner, Assistant Director, Division of Examinations
Mr. Landry, Assistant to the Secretary
Mr. Young, Senior Attorney, Legal Division
Mr. Partee, Chief, Capital Markets Section, Division of Research and Statistics
Mr. Loewy, Senior Economist, Division of Research and Statistics
Mr. Melichar, Economist, Division of Research and Statistics
Mr. Veenstra, Chief, Call Report Section, Division of Bank Operations

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on April 1, 1963, of the rates on

discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

Rate of interest on time certificates (Item No. 1). Under date of January 9, 1963, there were sent to all Reserve Bank Presidents copies of the Board's letter of January 7, 1963, to a member bank regarding the question whether the latter might continue to pay the rate of interest specified in a 3-year certificate of deposit bearing the maximum rate of interest permissible under Regulation Q, Payment of Interest on Deposits, if the Board should later reduce the maximum permissible rate below the contract rate. The letter of January 7 pointed out that according to section 217.3(b) of the Regulation no certificate of deposit shall be renewed or extended unless modified to conform to the provisions of the Regulation, and, further, that every member bank "shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to bring all of its outstanding certificates of deposit and other contracts into conformity with the provisions" of the Regulation.

There had now been circulated to the members of the Board a file containing a memorandum from Mr. Hooff dated March 22, 1963, relative to a question raised by The Franklin National Bank, Mineola, New York, as to whether the rates of interest paid on "Franklin Time Savings Certificates" with stated maturities of twenty years and in denominations (maturity value) ranging from $100 to $10,000 would be

affected by any future downward revision of the maximum rates provided in Regulation Q. There was also included in the file a draft of reply proposed to be sent to the New York Reserve Bank, through which the request from the member bank had come. Although, as noted in the memorandum, the Board's letter of January 7 dealt with a 3-year contract for deposit of public funds, whereas the present inquiry concerned 20-year certificates issued to the general public, it was believed that the January 7 letter answered the current inquiry and that a letter from the staff might have been sufficient. On the other hand, because of the more general and long-term application of such a reply in the present case, the staff believed it appropriate for the Board to review the letter proposed to be sent to the New York Reserve Bank.

The draft reply would state, in substance, that the Board's letter of January 7 appeared to answer the question presented by The Franklin National Bank and would note that inspection of the certificate enclosed with that bank's letter suggested that the bank might "consistently with its contractual obligations" modify the contract to provide for a lower rate, since the certificate contained the express provision that "the obligation to maintain this deposit and pay the maturity value is dependent upon and subject to present and future Federal laws and regulations."

At the request of the Board, Mr. Hooff commented on the question at issue, basing his comments substantially on his memorandum.

In further discussion, it was noted by the Board that the proposed letter seemed to be called for in light of the present provisions of Regulation Q. However, several of the members spoke skeptically or with disfavor concerning the adoption by banks of a practice of issuing long-term certificates of deposit at a fixed rate of interest; in other words, lending short and borrowing long. Reference was made to the possibility of amending Regulation Q so as specifically to require longer term certificates of deposit to contain language providing for modification of the interest rate thereon should the maximum permissible rate subsequently be reduced. It was suggested that such an amendment, which had recently been discussed by the Board, should be given further consideration.

The letter to the Federal Reserve Bank of New York regarding the rate of interest payable on the "time savings certificates" issued by The Franklin National Bank of Mineola, New York, was then approved unanimously. A copy is attached as Item No. 1.

Draft bill to amend Consolidated Farmers Home Administration Act (Item No. 2). Copies had been distributed of a draft of letter to the Bureau of the Budget responding to its request of March 13, 1963, for the Board's views on a draft bill proposed by the Department of Agriculture to amend the Consolidated Farmers Home Administration Act of 1961, as amended. The draft would state that the Board had no specific comments regarding the proposed legislation for the reason that it did not appear directly to concern the Board's primary responsibilities.

However, the letter would go on to question whether the legislation adequately took into account the principles for Federal credit activities advocated in the recent report to the President by the Committee on Federal Credit Programs. Reference would be made to the suggestion in the report that new credit programs be assigned to existing agencies whenever they served the same general purposes already served by such agencies and that every attempt be made to stimulate private lenders to fill credit gaps through co-insurance and other means before resorting to direct Federal lending.

The foregoing draft of reply had been prepared by the staff at the suggestion of Governor Shepardson following distribution of an initial draft that stated merely that the Board had no comments.

Governor Shepardson noted that the tone of the revised draft reply to the Budget Bureau had been purposely made restrained. Although a stronger and more detailed position against the draft bill might be taken, it had usually been the Board's practice to refrain from commenting in detail on bills that did not directly concern the Board's primary responsibilities. Therefore, the revised draft had been prepared along the lines indicated.

In answer to a question, Governor Shepardson itemized changes in the Consolidated Farmers Home Administration Act of 1961, as amended, that would be brought about by the draft bill, noting various reasons why the proposed changes would seem undesirable.

In further discussion the thought was expressed that a more detailed evaluation of the bill might be in order should the Board be requested to report to a Congressional committee, but that the revised draft appeared to be adequate for submission to the Budget Bureau. It was agreed, however, to modify the second paragraph by eliminating a sentence that would have stated that the Board had no specific comments on the proposed legislation because it did not concern the Board's primary responsibilities.

The letter was then approved for transmission to the Bureau of the Budget in the form attached as Item No. 2.

Reports on S. 607 and H. R. 258 (Item No. 3). There had been distributed a memorandum from the Legal Division dated March 18, 1963, regarding requests for reports on H. R. 258 and S. 607, identical bills "To authorize the establishment of Federal mutual savings banks." A draft of letter to Chairman Patman of the House Banking and Currency Committee reporting on H. R. 258 was submitted with the memorandum; and it was proposed that a similar letter be sent to Chairman Robertson of the Senate Banking and Currency Committee reporting on S. 607.

The memorandum from the Legal Division noted that H. R. 258 and S. 607 were substantially the same as bills on which the Board had previously reported to the Senate Banking and Currency Committee; no reports had previously been requested on such legislation by the House Committee. The memorandum referred to the fact that previous reports of the Board on such legislation had not taken a position concerning the principle of Federal chartering of mutual savings banks

although questions had been raised regarding particular features of the bills as introduced. In view of the widespread interest that had developed with respect to the legislation, it was the view of the staff that a similar report on the present bills might not be considered adequate. Therefore, it was recommended that there be submitted to both the Senate and House Committees a report stating that the Board had no objection in principle to the legislation but calling the Committees' attention to a number of objectionable provisions; and that there be enclosed a staff memorandum providing a detailed analysis and appraisal of the proposed legislation.

In reply to a question, Mr. Young of the Legal Division said that the proposed reports would not differ in essence from the position previously taken in letters of December 9, 1960, and January 19, 1962, to the Senate Banking and Currency Committee, aside from the inclusion of an explicit statement that the Board had no objection in principle to legislation that would authorize Federal charters for mutual savings banks.

Governor Mills raised the question whether it would not be more appropriate to detail the various structural deficiencies of the draft legislation in the Board's letter rather than to follow the procedure of attaching a staff memorandum. He was fearful that the proposed procedure could be interpreted as meaning that the Board was not taking responsibility for the various criticisms made in the staff memorandum.

Following discussion of this point, it was agreed to specify in the letter that the Board concurred in the views expressed in the memorandum.

Attention was then directed to the memorandum itself, and a general discussion of certain of the statements therein resulted in agreement on several changes.

After further discussion, approval was given to the transmission to the Banking and Currency Committees of the Senate and House of similar letters, each to be accompanied by a copy of the staff memorandum in form reflecting the changes agreed upon at this meeting. A copy of the letter, with enclosure, sent to the Senate Banking and Currency Committee is attached as Item No. 3.

Messrs. Cardon, Young (Legal), and Loewy then withdrew from the meeting.

Status of municipal bonds bought by a bank with option to resell (Item No. 4). Copies had been distributed of a memorandum from the Legal Division dated March 27, 1963, regarding the status as investments or loans of municipal bonds bought by a bank with an option to resell. The question arose from a practice of Morgan Guaranty Trust Company of New York, which for several years had made funds available to dealers in municipal securities under circumstances that gave rise to the problem whether such transactions should be classified in reports of condition and examination reports as loans or as investments in securities. The New York Reserve Bank had inquired whether the Board would acquiesce in the member bank's "continuing to report these transactions as investments rather than loans."

In reviewing the matter, the memorandum referred to the position taken by the Comptroller of the Currency and the Board in 1957 that sale and repurchase transactions, despite their investment form, actually were loans in purpose and effect, and therefore were subject to statutory loan limits. (Subsequently, the Comptroller exercised his authority under section 5200(8) of the Revised Statutes to permit unlimited loans on the security of Federal Government obligations maturing within 18 months.)

Although the transactions involved in the Morgan Guaranty situation were repurchase arrangements, the memorandum noted a number of features serving to distinguish them from the Federal funds type of situation that prompted the 1957 ruling. The securities sold were municipal rather than Federal Government securities; Morgan Guaranty received interest at the rate prescribed by the securities rather than at a stated interest rate; the transactions covered at least two weeks, with an average duration of over one month; and the resale rights and obligations were not mutual since Morgan Guaranty had a unilateral option to resell the municipal securities involved at the price paid for them or "the then market, whichever is higher."

Morgan Guaranty took the position that, as owner of the municipal securities concerned, the interest received was interest on those securities and therefore was exempt from Federal income taxation. As noted in the memorandum, the Internal Revenue Service apparently did

not object to this treatment by Morgan Guaranty of its interest income from the securities involved.

The memorandum stated the opinion of the Legal Division that, from the standpoint of bank supervision at least, the arrangement gave rise to loans by the bank rather than ownership of municipal bonds. However, there was admittedly some element of doubt. Among other things, Counsel for Morgan Guaranty, a leading New York law firm, had expressed the opinion that the arrangement amounted to the purchase of securities rather than a loan; the New York Reserve Bank had expressed the hope that the Board could go along with the opinion expressed by Counsel for Morgan Guaranty; and the Internal Revenue Service had not taken exception to the manner in which these transactions were handled by Morgan Guaranty.

In view of these various considerations, it was the Legal Division's recommendation that the Board not object to Morgan Guaranty's continuing to report such transactions as investments in securities. In making this recommendation the Legal Division suggested that the Board not go on record as either accepting or rejecting Morgan Guaranty's position in this matter, and that the Reserve Bank be requested to inform the Board if and when the practice spread or changed in character to any material extent. Attached to the memorandum was a draft of letter to the New York Reserve Bank to this effect. The Legal Division also recommended that the Office of the Comptroller of the Currency be informed

of the Board's proposed action to afford opportunity for interagency consultation if the Comptroller should so desire.

In commenting on the memorandum of the Legal Division, Mr. Hexter reported advice from the New York Reserve Bank that leading New York City State member banks were following divergent practices regarding the type of transaction under consideration. One bank was reporting such transactions as loans but nevertheless claiming a tax exemption on the interest income; another was reporting the transactions as loans and paying taxes on the interest income; another had stopped entering into such transactions.

In discussion, Governor Robertson stated that he realized the difficulty involved in reaching a clear determination of the matter in view of the intricacies of this kind of transaction. Nevertheless, he felt it was undesirable to send a letter to the New York Reserve Bank phrased in terms that the Board would not object to such transactions continuing to be reported as investments. Should the Reserve Bank transmit such a position to member banks, the practice might spread quickly. In the circumstances, he suggested revised language for parts of the proposed letter so as to state, in effect, that examiners for the Reserve Bank need not question such transactions for the time being, but that developments might make it necessary for the Board of Governors to issue general interpretations on the subject.

There being general agreement with these suggested changes, unanimous approval was given to a letter in the form attached as Item No. 4.

At this point Mr. Hexter brought out that about two years ago the Office of the Comptroller of the Currency had indicated informally to the Board's staff that it would be inclined to regard such transactions as loans, although perhaps without having the benefit of full information at hand at the time. He inquired whether it would be the Board's desire that he check again with the Comptroller's Office to see whether there had been any change in view, in the interest of achieving uniformity of interpretations. It was agreed that Mr. Hexter should check with the Comptroller's Office and that he would report to the Board if any general disagreement were found.

Secretary's Note: Upon checking with the Comptroller's Office, Mr. Hexter was informed that the Office had changed its position on the entire subject of repurchase transactions; that if a transaction was in the form of a purchase of securities, the Office would not object to its being reported as an investment in securities rather than a loan and would not regard such a transaction as subject to the statutory loan limitations. It was understood that the Comptroller was considering the issuance of an opinion to such effect. This information was reported to the Board in a memorandum distributed under date of April 3, 1963.

Messrs. Koch, Holland, Benner, Partee, and Melichar withdrew from the meeting at this point.

Publication of reports of condition. Under date of March 28, 1963, copies had been distributed of a memorandum from Messrs. Veenstra and Farrell attaching a copy of a letter addressed by the Comptroller

of the Currency to all national banks under date of March 8, 1963. In effect, the letter stated that for the purpose of reducing the administrative and expense burden incident to publication of reports of condition, national banks would have the option, effective immediately, of deferring publication of the spring and fall reports and of publishing the data so collected in comparative columnar form with the June and December call reports. The memorandum noted that this action on the part of the Comptroller raised a question as to whether State member banks would be discriminated against if the Board continued to require them to publish on a current basis spring and fall call report data. A distributed memorandum from the Legal Division dated March 26, 1963, stated the opinion that neither the Board nor the Comptroller may by regulation or otherwise permit member banks to delay publication of call reports for a period of months.

In the circumstances, the staff proposed for the Board's consideration as possible alternative courses of action the following: (1) reference to the Attorney General of the conflicting interpretations of law; (2) the sending of a letter to all Reserve Banks asking for their views on the question and suggesting that they solicit comments from each State banking department in their districts as to whether State banks could or should be given an option similar to that given to national banks by the Comptroller; (3) a Legal Division review of all State statutes to determine whether an amendment to the Federal statutes would permit the Board to allow a significant number of State

member banks to delay or forego publication of certain call reports; and (4) a Board-initiated proposal that the three Federal supervisory agencies review the continuing need and format of spring and fall call reports and their publication, with the thought that the Board could collect by means of sampling arrangements the needed statistical information now being taken from the spring and fall call reports.

At the request of the Board, Mr. Farrell outlined the situation, basing his comments on the memorandum of March 28.

Governor Mills remarked that there was an additional alternative to those suggested in the memorandum, namely, for the Board simply to adhere to its present position. He noted that the Comptroller's letter of March 8 was permissive in nature and that in recent conversation with representatives of a State bankers association who had visited the Board's offices, hardly any of the national bankers in the group indicated a desire to accept the option provided by the Comptroller. Governor Mills agreed with the position taken in the memorandum of the Legal Division to the effect that publication of the call reports was required by statute and that the presumed purpose of publication was to acquaint the public with the current condition of banks. This purpose would not be served if publication of the spring and fall reports were delayed until the next report was published.

There developed to be general agreement with the views expressed by Governor Mills in this regard. Hence, so far as the immediate question raised in the Veenstra-Farrell memorandum was concerned, it

was understood that the Board would leave unchanged, at least for the time being, its outstanding instructions with regard to the publication of reports of condition by State member banks.

Chairman Martin then turned to Mr. Noyes for comment on the status of the work being done by the interagency staff group assigned to study various phases of the call report procedure. (This group consisted of two representatives each from the Board, the Comptroller's Office, and the Federal Deposit Insurance Corporation, with Messrs. Noyes and Holland representing the Board.)

Mr. Noyes reported that he had been meeting both with the interagency group and with representatives of the Federal Reserve Banks. He noted that the Comptroller was pushing for a reduction in the number of calls and for a reduction in the amount of detail required in connection with each call. The first of the two steps would require legislation. So far as the second was concerned, it seemed to Mr. Noyes that perhaps some progress could be made toward reducing the number of calls at which full detail would be required. On the other hand, substantially the current amount of detail as now obtained was thought to be needed rather importantly at least once and perhaps twice each year, although there might be some modifications in the form of the call report at each call date. The matter was urgent in the sense that the Comptroller apparently would like to announce certain changes in the form of the call report in connection with the midyear call even though the changes might not be made effective at such time.

After further comments by Mr. Noyes along these lines, Chairman Martin expressed the view that it would seem desirable to have a meeting shortly that could be attended by the Comptroller, members of the Board (including Governor Mitchell), and some of the Reserve Bank Presidents.

Secretary's Note: Such a meeting was held on the afternoon of April 16, 1963.

Governor Mills noted that there were two different approaches to be taken to the call reports. On the one hand, they might be regarded as reports designed to disclose to the public the position of individual banks. On the other hand, the reports provided statistical data for the supervisory agency which, as indicated in the memorandum of March 28, might be provided to a degree by sampling procedures. Over the years, Governor Mills noted, there had been a gradual tendency to ask banks for more and more information. It might be possible to backtrack somewhat and require a lesser volume of statistical data from the banks; but he thought it important not to abolish the periodic publication of bank statements.

It was noted, in further discussion, that the Comptroller was not advocating elimination of publication of the face of the call reports but was advocating a reduction in the frequency of these reports from four to two times a year, which he realized would require a change in existing law, along with simplification.

Request of Chairman Patman. Chairman Martin and Mr. Sherman reported, as a matter of information, that the Federal Reserve Bank of

New York was in receipt of a request from Chairman Patman of the House Banking and Currency Committee for the minutes of the Bank's directors' meetings for certain years, along with related papers. The Reserve Bank was reported to be studying the request, prior to presentation of the matter to its directors, and it was understood that the Reserve Bank would be in touch with the Board after further study.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following items:

Telegram to the Federal Reserve Bank of Kansas City (attached Item No. 5) approving the appointment of Peter V. C. Wasson as assistant examiner.

Memoranda from appropriate individuals concerned recommending increases in the basic annual salaries of the following persons on the Board's staff, effective April 14, 1963:

Name and title	Division	Basic annual salary From	To
	Research and Statistics		
Barbara A. Bosworth, Statistical Clerk		$ 4,110	$ 4,250
Jean C. King, Technical Editor		6,675	6,900
Dorothy E. Swink, Statistical Assistant		4,885	5,045
	International Finance		
Katherine M. Bulow, Clerk-Typist		3,925	4,030
Thomas M. Klein, Economist		11,515	11,880
	Examinations		
Robert F. Achor, Review Examiner		11,150	11,515
John N. Lyon, Review Examiner		11,150	11,515
John M. Poundstone, Review Examiner		11,150	11,515
Jeannette Somlyo, Stenographer		4,390	4,530

Salary increases, effective April 2, 1963 (continued)

Name and title	Division	Basic annual salary From	To
	Administrative Services		
Virginia F. Gums, Charwoman		$3,350	3,455

Secretary

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

Item No. 1
4/2/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 2, 1963

Mr. Howard D. Crosse, Vice President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Mr. Crosse:

This refers to your letter of February 20, 1963, enclosing a letter from The Franklin National Bank, Mineola, New York, presenting the question whether the rate of interest specified in the 20-year time savings certificates issued by that bank would be affected by any future downward revision of the maximum rates provided in Regulation Q.

Under date of January 9, 1963, the Board furnished each Federal Reserve Bank a copy of the Board's letter of January 7, 1963, answering a similar question presented by a member bank with respect to 3-year certificates of deposit. The Board referred to section 217.3(b) of Regulation Q, which provides that no certificate of deposit shall be renewed or extended unless modified to conform to the provisions of the Regulation, and, further, that every member bank "shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to bring all of its outstanding certificates of deposit and other contracts into conformity with the provisions" of the Regulation. The Board advised the bank that if, during the 3-year period of the contract, the Board should reduce the maximum permissible rate to a percentage lower than that stipulated in the contract, the member bank could continue to pay the contract rate until the end of the 3-year period if it could not "consistently with its contractual obligations" modify the contract to provide for the lower rate.

This recent pronouncement by the Board appears to answer the question presented by The Franklin National Bank. However, inspection of the certificate enclosed with that bank's letter suggests that the bank might "consistently with its contractual obligations" modify the contract to provide for a lower rate, since the certificate contains the express provision that "the obligation to maintain this deposit and pay the maturity value is dependent upon and subject to present and future Federal laws and regulations."

As you know, the Board has considered amending section 217.3(b) of Regulation Q so as specifically to require certificates to contain a provision providing for modification of the interest rate if the rate should subsequently be reduced and if the Board should not permit the continued payment of interest at the rate provided in the certificate. As an alternative, consideration has been given to an amendment that would merely make clear the authority of the Board to require reduction of the rate under outstanding contracts. However, the Board has not reached a decision as to the need for and the nature of such an amendment, and, since The Franklin National Bank's question was presented over a year ago, it seem desirable to supply an answer on the basis of the Regulation as it now exists.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 2
4/2/63

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 2, 1963.

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

Dear Mr. Hughes:

This is in response to your communication of March 13, 1963, requesting the Board's views on a draft bill, proposed by the Department of Agriculture, to amend the Consolidated Farmers Home Administration Act of 1961, as amended.

The Board questions whether the proposed legislation adequately takes into account some of the desirable principles for new Federal credit activities described in the recent report of the Committee on Federal Credit Programs to the President. These included, for example, the thought that new credit programs should be assigned to existing agencies whenever they serve the same general purposes already served by such agencies, and the suggestion that every attempt be made to stimulate private lenders to fill credit gaps through co-insurance and other means before resorting to direct Federal lending.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 3
4/2/63

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

April 4, 1963

The Honorable A. Willis Robertson,
Chairman,
Committee on Banking and Currency,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your request of February 4, 1963, for a report on the bill, S. 607, "To authorize the establishment of Federal mutual savings banks."

While the Board has no objection in principle to legislation that would authorize Federal charters for mutual savings banks, it is the Board's view that S. 607 contains a number of objectionable provisions. These relate mainly to the very broad investment powers which the bill would grant to such banks, the determination of the powers of such institutions in accordance with the minimum standards set by State law rather than by Federal law or regulation, and the limited regulatory powers of the chartering agency. With respect to the latter, while the Home Loan Bank Board would be given authority under the bill to liberalize mortgage lending terms further, no parallel authority is provided for tightening terms, regardless of circumstances.

A more detailed analysis and an appraisal of these, as well as other provisions of the bill, are contained in the enclosed memorandum, which was prepared by the Board's staff and in which the Board concurs.

Sincerely yours,

Wm. McC. Martin, Jr.

Enclosure

STAFF COMMENTS ON H.R. 258 AND S. 607
TO AUTHORIZE THE ESTABLISHMENT OF
FEDERAL MUTUAL SAVINGS BANKS

H.R. 258 and S. 607 are identical bills to authorize the establishment of Federal mutual savings banks as members of the Federal Home Loan Bank System, either through the conversion of existing mutual savings banks and savings and loan associations or the chartering of new banks. As in previous bills introduced in the 86th, 87th, and 88th Congress, the explicit purpose of the proposed legislation is to promote maximum employment and production by encouraging an "increased flow of real savings to finance new housing and other capital formation on a sustainable noninflationary basis."

In its reports on similar bills proposed in the past, the Board questioned whether the establishment of Federal mutual savings banks would do much more than redirect rather than increase the flow of savings, and whether the public interest would necessarily be served by the rearrangement of saving, financial, and competitive relationships among financial institutions that would follow the establishment of Federal mutual savings banks. The Board stated that in areas already served by the facilities of existing thrift institutions, Federal mutual savings banks would compete with institutions having large liabilities to millions of savers. The Board's opinions on earlier bills apply with equal appropriateness to H.R. 258 and S. 607.

Although there may appear to be no objection in principle to increasing competition among savings institutions by establishing Federally-chartered mutual savings banks, H.R. 258 and S. 607 have a number of serious defects. These relate mainly to the very broad investment powers granted, the extent to which regulatory authority is circumscribed, and the extent to which the powers of such institutions would be determined by State law.

In reviewing earlier bills, the Board commented that the investment powers recommended for Federal mutuals were quite liberal compared with the powers of existing thrift institutions and commercial banks. Of special concern was authorization to invest in common stocks up to 5 per cent of the assets of savings banks (or up to 100 per cent of reserve funds and undivided profits), in conventional mortgages up to 30 years and 90 per cent of appraised value, and in mortgages on "any other real property" (presumably including unimproved land) up to 75 per cent of appraised value.

These investment powers are unchanged in the pending bills.

It may be argued that thrift institutions should hold no investments in corporate stocks. Any such holdings would be subject to variations in market valuation over time, while the obligation to savers must be to return the number of dollars deposited. On the other hand, mutual savings banks have in practice invested moderate amounts in stocks under the supervision of State banking departments. But consideration should be given to tightening the stock investment provision of these bills by imposing, at the least, a strict limitation on the amount of stock of any corporation that could be purchased, and a more restrictive aggregate limitation on the total book value of such investments. Since the banks would be authorized to invest up to 50 per cent of their undivided profits and reserve fund in real property assets, which also are variable in value, a parallel limitation on corporate stock investment powers might seem appropriate.

There is no objection to the provision which permits Federal mutual savings banks to invest without limit in the obligations of the United States, guaranteed or insured Federal or State agency obligations (including Federal Home Loan Bank Board debentures), municipal bonds, Canadian and provincial obligations, bonds of the International Bank for Reconstruction and Development and the Inter-American Development Bank, and in first mortagage bonds and notes.

Other types of investment permitted are promissory notes secured by mortgages, stocks, and bonds, in which "a savings bank may invest". This is not much of a limitation, given the wide investment powers otherwise provided. Federal mutuals could in fact become a significant source of stock market credit if this provision and the authority to invest in corporate stock is retained. The banks may also invest in promissory notes secured by assignment of deposits or share accounts in any thrift institution subject to Federal or State regulation, and in other secured or unsecured promissory notes "containing terms conforming to regulations to be prescribed" by the FHLBB.

Of chief concern are the extremely liberal rules governing mortgage investment. Investment in any one mortgage must not exceed 2 per cent of the assets of a savings bank or $25,000, whichever is greater, but the limitation does not apply if the Federal Home Loan Bank Board authorizes greater amounts. With regard to mortgages on one-to-four family residential properties, loans may be made without limit for amounts up to 90 per cent of the appraised value, and for maturities of up to 30 years. The savings banks may also lend up to 75 per cent of the appraised value of any other real property and this includes, presumably, unimproved land. There is no provision requiring amortization of such loans. While the Home Loan Bank Board is given authority to liberalize mortgage lending terms further, there is no parallel authority to tighten terms, regardless of circumstances.

There is a real possibility that such liberal investment provisions could result in competitive deterioration in the quality of mortgage credit, tending to jeopardize the asset structure of not only the Federal mutuals but also other financial institutions. This is particularly true, given the emergence of the new mutual institutions as competitors and in view of the wide variation in appraisal and valuation methods among institutions and from State to State. Vigorous competition for mortgage loans already prevails, and abuses resulting from appraisal procedures could multiply.

Although it would be inappropriate to specify in the proposed legislation detailed rules of appraisal valuation, a general authorization permitting the FHLBB to apply strict rules of appraisal and valuation techniques, combined with authority to specify stricter credit terms for specific classes of mortgages, would seem highly desirable. Such provisions, warranted by the uncertainties of the future alone, are even more appropriate where the introduction of a new competitive element may have a significant impact on the structure of credit markets.

Along the same lines, there is nothing in the proposal to suggest that Federally-chartered savings banks will be subject to regulation of interest rates paid on deposits. Obviously, competition for deposits in areas where institutional savings facilities are abundant might lead to severe rate competition with possible injury to thrift institutions generally. Also, minimum standards of liquidity are not provided, even though the mutuals are ordinarily required to meet all deposit withdrawal demands within 90 days. In both cases, broad authority for the Board, on a standby basis, would seem in order.

The proposed Federally-chartered mutual savings banks would have important tax advantages over commercial banks. Although the Revenue Act of 1962 revised and tightened the provisions permitting mutual savings institutions to add to bad debt reserves, the law as amended still confers on mutual savings banks tax advantages over commercial banks. Furthermore, the present proposal insures unusually favorable State-local tax treatment by prohibiting the imposition of any tax on Federally-chartered mutual savings banks greater than "the least onerous imposed or permitted by such State or political subdivision on any other local financial institution."

The merger and consolidation provisions of the two bills are subject to none of the standards provided in the Bank Merger Act of 1960, which require the appropriate supervisory agency, before granting consent to a merger or consolidation, to find that the transaction would be in the public interest, after taking into account a number of factors, including the convenience and needs of the community to be served, and the effect of the transaction on competition. Also, the bills provide that a savings

bank resulting from a merger may retain and operate any one or more offices in operation on the date of the merger, and apparently would permit, with the approval of the Federal Home Loan Bank Board, the establishment of State-wide branches.

Three separate sections of the bills may be interpreted as implying some latitude for the Federal Home Loan Bank Board to establish qualitative standards of investment. Section 107 states that "A savings bank may borrow funds [presumably from the Federal Home Loan Bank System] subject to such regulations as the Board may prescribe." Section 114 requires that "The Board shall conduct an examination at least once in each calendar year into the affairs and management of each savings bank for the purpose of determining whether such savings bank is being operated in conformity with the provisions of this Act, any rules and regulations promulgated hereunder, and sound banking practice. . . ." Section 115 states that "The Board shall have power to make and publish, as provided by the Administrative Procedure Act, general regulations applicable to all savings banks implementing this Act and not in conflict with it. The Board shall have power to supervise savings banks and require conformity to law and regulations."

Whether these very general provisions for regulatory authority are adequate is debatable, particularly where it is also specified that all Federal mutuals, regardless of any law or regulation, shall have all the powers now or (with the approval of the Home Loan Bank Board) hereafter granted to State-chartered mutuals in the State where the Federal mutual savings bank is located. It seems clear that this provision, which in effect permits minimum standards of performance for both the Federal- and State-chartered institutions within a State to be set by independent State legislation, presents a dangerous departure from present Federal financial legislation.

Item No. 4
4/2/63

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 4, 1963.

Mr. Howard D. Crosse, Vice President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Mr. Crosse:

This is with reference to the question, presented in your Bank's letters of June 12, 1958, January 21, 1960, and March 22, 1963, whether certain transactions between Morgan Guaranty Trust Company and municipal bond dealers should be reported as loan transactions or as investments in securities.

The Board is inclined to conclude that arrangements of the kind described in said letters constitute in reality loans rather than securities transactions. (Enclosed for your information is a memorandum of the Board's Legal Division, dated March 27, 1963, that discusses the problem.) However, because of the form and certain terms of such arrangements the matter is susceptible of conflicting opinions. Accordingly, in view of the circumstances and in the absence of developments of the kinds described in the last sentence of this letter, no question need be raised, for the time being, if such transactions continue to be reported as investments.

The Board believes that a definitive position on the question should not be taken at this time. Instead, your Bank is requested to keep currently informed, as far as possible, regarding the use of arrangements of this nature by commercial banks. If the practice should become widespread or tend to develop in a manner detrimental to the banking system or likely to impair the accuracy and the informative quality of published reports of condition, it might become advisable for the Board of Governors to issue a general interpretation on the subject.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

Item No. 5
4/2/63

TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

April 2, 1963.

MILLS - KANSAS CITY

IN ACCORDANCE WITH THE REQUEST CONTAINED IN YOUR LETTER OF MARCH 25, 1963, THE BOARD APPROVES THE APPOINTMENT OF PETER V. C. WASSON AS AN ASSISTANT EXAMINER FOR THE FEDERAL RESERVE BANK OF KANSAS CITY. PLEASE ADVISE THE SALARY RATE AND THE EFFECTIVE DATE OF THE APPOINTMENT.

IT IS NOTED THAT MR. WASSON IS INDEBTED TO THE AMERICAN NATIONAL BANK OF DENVER, DENVER, COLORADO AND TO GUARANTY BANK AND TRUST COMPANY, DENVER, COLORADO, A NONMEMBER BANK. ACCORDINGLY, THE BOARD'S APPROVAL OF MR. WASSON'S APPOINTMENT IS GIVEN WITH THE UNDERSTANDING THAT HE WILL NOT PARTICIPATE IN ANY EXAMINATION OF EITHER BANK NAMED ABOVE SO LONG AS HIS INDEBTEDNESS THERETO REMAINS UNLIQUIDATED.

(Signed) Kenneth A. Kenyon

KENYON