

R 609
Rev. 9/61

Minutes for June 18, 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	<u>W</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>

1/ Meeting with Presidents of the Federal Reserve Banks.

A joint meeting of the Board of Governors of the Federal Reserve System and the Presidents of the Federal Reserve Banks was held in the Board Room of the Federal Reserve Building in Washington, D. C., on Tuesday, June 18, 1963, at 12:20 p.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Farrell, Director, Division of Bank Operations
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Kiley, Assistant Director, Division of Bank Operations

Messrs. Hayes, Bopp, Hickman, Wayne, Bryan, Scanlon, Shuford, Deming, Clay, and Irons, Presidents of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, and Dallas, respectively

Messrs. Latham and Hemmings, First Vice Presidents of the Federal Reserve Banks of Boston and San Francisco, respectively

Mr. Boykin, Secretary of the Conference of Presidents of the Federal Reserve Banks
Mr. Timlen, Assistant Secretary of the Conference of Presidents of the Federal Reserve Banks

There had been distributed a memorandum from the Conference of Presidents regarding the items that had been suggested for consideration. The items, the statements of the Conference with respect to them, and a summary of the discussion at this meeting follow:

6/18/63

-2-

A. Changing Deferment Schedules from a Two-day to a Three-day Maximum to Reduce Float.

The May 22, 1963 report of the Subcommittee on Collections to the Committee on Collections and Accounting, regarding check float was presented by Mr. Deming, Chairman, Committee on Collections and Accounting.

A summary statement of the findings of the Subcommittee reflects that:

"1. A survey conducted by the Subcommittee indicates that the average daily time schedule float on interdistrict country items, the largest component of float, amounted to approximately \$742 million during the last quarter of 1962 as compared to \$624 million in the last quarter of 1959, an increase of \$118 million, or approximately 19 per cent. The percentage increase corresponds closely with the percentage increase in the volume of country checks handled by the Federal Reserve System.

"2. Another survey conducted by the Subcommittee indicates that the average daily amount of holdover float for April 1963 was \$488 million as compared to \$93 million in April 1958, an increase of \$395 million, or approximately 422 per cent. Since total System float in April 1963 was considerably lower than the average of total System float for the calendar year 1962, it is believed that the average daily holdover float for the calendar year 1962 may have been as much as \$100 million higher than the April 1963 average of \$488 million.

"3. Based on the aforementioned two surveys, the Subcommittee is of the view that these two components of float, which are the only components that can be feasibly controlled, accounted for at least 75 per cent of the daily average System float of \$1,603 million during 1962 and for at least 95 per cent of the increase of \$612 million in such float since 1958."

In addition to the foregoing findings, the Subcommittee expressed the view that:

"(a) Conversion to mechanized operations cannot be expected to have any noticeable impact on time schedule float, since the use of high-speed equipment will not reduce the time required to collect interdistrict country items.

6/18/63

-3-

"(b) The principal factors resulting in a substantial increase in holdover float in recent years have been (1) problems incident to the changeover to electronic equipment which have served temporarily to disrupt rather than to facilitate check handling operations, and (2) the shortage and turnover of personnel at several of the Federal Reserve offices, particularly at Chicago, Los Angeles, and New York (these three offices accounted for 75 per cent of the increase in holdover float since 1958).

"(c) Float arising from interdistrict country items is related almost entirely to the volume of sendings and is likely to continue to increase, unless a change is made in the time schedules of the Federal Reserve Banks, since such items cannot be collected in less than three days.

"(d) Holdover float is more likely to decrease rather than increase in the future, and as dollar encoded checks deposited with the Federal Reserve Banks for collection increase in volume and additional high-speed equipment is acquired, the Federal Reserve Banks should be able to effect a sizable reduction in holdover float. However, a complete elimination of holdover float would be uneconomical because of the wide fluctuations in the volume of checks received for collection by the larger Federal Reserve offices."

It was noted that Mr. Farrell of the Board's staff had made some estimates of additional costs involved if actions were taken to reduce holdover float and of additional net gains to the Treasury if the reserve losses from lengthening the time schedule to three days for interdistrict country items were offset by System purchases of Treasury bills. Both of these figures were of the general order of magnitude of \$10 million.

The Conference view was that it would be uneconomic to spend \$10 million to reduce holdover float at this time, particularly in view of the probability that natural forces would cut it back as the transition period for check collection automation passed. The Conference also felt that it would be unrealistic to assume that System action to offset reserve losses stemming from reduction in time schedule float would be taken via security purchases.

The Conference concluded that the present two-day deferment for interdistrict country items was not realistic, that the provision of reserves via float was not consistent with legal restrictions relating to uncollected funds, and that growth in float volume posed considerable problems for

6/18/63

-4-

the administration of the Open Market Account. At the same time, the Conference recognized that a change to three-day deferment for interdistrict country items would pose great problems because the present deferment schedule had been integrated into the institutional structure of our payments system and because of relationships with the banks, especially during this period of adjustment to MICR processing. The Conference felt that the question of timing of any change in deferment schedules was of paramount importance, that it would be undesirable to take such action now or in the foreseeable future without offsetting action in reserves, that within the foreseeable future it would be unwise for such offsetting action to come via security purchases, and consequently that any such move to eliminate time schedule float should wait until it seemed appropriate to offset the reserve effects via changes in reserve requirements.

In a letter to the Board dated March 5, 1963, Congressman Fascell, Chairman of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations, requested the Board's present views with respect to certain matters on which the Board had submitted comments several years ago to the Foreign Operations and Monetary Affairs Subcommittee. One of these was the matter of check float, particularly the question of changing deferment schedules from a two-day to a three-day maximum to reduce such float. The Board's previous letter expressing its views on this subject was dated April 14, 1961. Upon receipt of Chairman Fascell's recent letter, the Board requested the views and comments of the Presidents' Conference, and subsequently the Conference Subcommittee on Collections instituted a study that resulted in a report dated May 22, 1963.

At the request of the Conference Chairman, Mr. Irons, the findings of the Subcommittee on Collections and the conclusions of the Presidents' Conference were reviewed by Mr. Deming, Chairman of the

6/18/63

-5-

Committee on Collections and Accounting, whose comments reflected the statement contained in the memorandum that had been distributed prior to this meeting. Mr. Deming noted that the Conference had not undertaken to suggest specifically what form of reply might be made by the Board to Chairman Fascell. However, the Conference would be glad to assist in the drafting of such a reply to whatever extent might be desired by the Board.

In the discussion that followed, Mr. Hayes stressed the importance of the MICR program as a factor bearing upon the timing of any change in deferment schedules. When this program had moved further toward completion, check-sorting requirements should be less onerous, and at that time a change to a maximum three-day deferment would be more palatable, assuming that it was combined with offsetting action on reserves. He felt that within 18 months or two years the MICR Program might have progressed to the point where a change in deferment schedules would be more timely.

In reply to a question, Mr. Deming indicated that the Conference fully recognized the scope of the bank relations problem. This went beyond the MICR program, although it was accentuated at present because of that program. The two-day maximum deferment was admittedly unrealistic for interdistrict country items, and there seemed to be little likelihood of reducing the volume of time schedule float. But the two-day maximum deferment had been in effect for some 13 years, and it was integrated with the institutional fabric of the payments system.

6/18/63

-6-

In response to an inquiry about the possibility of offsetting an action on maximum deferment by way of security purchases, Mr. Deming observed that a question of judgment was involved. However, it seemed to the Presidents that there was probably no very good time for a reserve adjustment of the necessary magnitude to be made conveniently through open market operations. Operationally it would seem more logical to restore the \$3/4 billion of reserves by a change in reserve requirements.

Mr. Hemmings commented on progress that had been made recently in reducing holdover float at the Los Angeles Branch, following which Mr. Deming summarized by saying that the Board's comments to the House Foreign Operations and Monetary Affairs Subcommittee in 1961 appeared to the Conference to have been somewhat too optimistic insofar as the possibility of a reduction of float arising from interdistrict country items was concerned. However, most of the reasons given in 1961 against moving to a three-day maximum deferment continued to be pertinent. In addition, there was the factor of the MICK program, along with perhaps a little more awareness of the extent to which the two-day maximum deferment had become integrated into the institutional fabric of the payments system.

B. Local Destruction of Federal Reserve Notes and One Central Issue of Federal Reserve Notes.

The June 7, 1963 report of the Subcommittee of Counsel on Fiscal Agency Operations concerning the captioned topics concluded, according to Mr. Wayne, Chairman, Committee on Fiscal Agency Operations, that there have been no developments which would affect the Board's 1960 comments except in the area of

6/18/63

-7-

costs, particularly the effect on costs of the replacement of \$1 silver certificates by \$1 Federal Reserve notes. He said that after consideration of the Subcommittee Report the Committee recommended that:

1. \$1 and \$2 Federal Reserve notes should be destroyed at the Reserve Banks in whole-note form;
2. \$1 and \$2 Federal Reserve notes should be redeemed on a formula basis in order to eliminate the necessity of sorting them by bank of issue;
3. No change should be made at this time with respect to the present requirements regarding destruction of Federal Reserve notes of the denomination of \$5 and up; and
4. Any change from twelve separate issues of Federal Reserve notes to one central issue should not be made for the following reasons:
 - a. The psychological effects of such a change which might result in a possible loss of confidence, and
 - b. The erosion of the regional character of the Reserve Banks, and the consequent loss of their identity remain valid arguments against one central issue of Federal Reserve notes.

Considering the economic advantage only of one central issue, it was the view of the Committee that the savings which would result stem primarily from the present sorting-by-bank-of-issue requirement, which can be eliminated in other ways, for example, by providing for redemption on a formula based on issuance or past experience. However, suggesting a change of this nature with respect to all Federal Reserve notes would present certain problems insofar as distinguishing between such a change and a change to one central issue is concerned. These problems would not appear to be as significant if a change of this kind were suggested only with respect to \$1 and \$2 Federal Reserve notes, though, particularly if coupled with the question of local destruction of \$1 and \$2 Federal Reserve notes, because of (1) the small dollar amount of \$1 notes as compared to the amount of other notes, (2) the large number of unfit \$1 notes as compared to the total number of unfit notes, (3) the sorting increase resulting from the change to \$1 and \$2 Federal Reserve notes as compared to continuing present sorting costs for other denominations, and (4) the fact \$1 and \$2 Federal Reserve notes represent a new addition to the currency structure.

6/18/63

-8-

After discussion, the Conference voted on each of the four recommendations separately. They all carried unanimously with the exception of recommendation numbered 3 above. In this regard, Mr. Hickman dissented on the basis that there should be local destruction of \$5 and \$10 Federal Reserve notes since the Reserve Banks are presently destroying \$5 and \$10 Treasury currency. While voting in favor of the recommendation, Mr. Hayes expressed doubt whether the recommended cut-off point was the appropriate one.

In connection with the March 5, 1963, letter from Chairman Fascell, the Board had also requested the views and comments of the Presidents' Conference with respect to two matters, other than float, on which the Board had previously submitted comments to the House Foreign Operations and Monetary Affairs Subcommittee. One of these was the question of one central issue of Federal Reserve notes, with respect to which the Board transmitted comments to the Subcommittee on December 22, 1960; the other was the question of local destruction of Federal Reserve notes, with respect to which the Board submitted memoranda on June 29 and August 18, 1960. These subjects had been referred for study to the Conference Subcommittee of Counsel on Fiscal Agency Operations, which submitted a report dated June 7, 1963.

Mr. Wayne, Chairman of the Committee on Fiscal Agency Operations, reviewed the recommendations of the Subcommittee and the actions taken with respect thereto by the Presidents' Conference, his comments being based on the statement contained in the memorandum distributed prior to this meeting.

6/18/63

-9-

Mr. Wayne also said the Conference felt that the System should seek or endorse such legislation as might be necessary to permit implementation of the recommended procedures in regard to the redemption and destruction of Federal Reserve notes. The Conference would see no objection to such legislation being broad enough to cover Federal Reserve notes of all denominations. Nevertheless, it was the majority view of the Conference that only the \$1 and \$2 notes should be destroyed locally at this time. With the development of experience, the Reserve Banks would be in a better position to move on from that point. He noted, however, that there was variation of opinion within the Conference, on a risk basis, regarding local destruction of notes of high denominations.

Mr. Hayes indicated that he had quite a strong feeling as between \$1 and \$2 notes and \$20 notes; the \$5 and \$10 notes seemed to him borderline. The chance of collusion was greater when notes were redeemed and destroyed at the same place, and he thought it was worthwhile to minimize the risk.

Mr. Hickman said that the operating personnel at the Cleveland Bank would be inclined to go all the way, feeling that the risks were more theoretical than real and realizing that a substantial savings would be involved. Personally, he believed that local destruction of \$5 and \$10 notes would be warranted; the Reserve Banks were now destroying Treasury certificates of those denominations.

In further discussion, Mr. Wayne emphasized that there was no disposition within the Conference to try to force the sending of \$1 and \$2 notes to Washington for destruction. It was agreed that

6/18/63

-10-

they should be destroyed locally, and in whole-note form. The Reserve Banks should develop a formula for redemption so as to achieve the maximum feasible savings in the handling of these notes. However, it was the sense of the Conference that the Reserve Banks should acquire some experience before consideration was given to moving further in the direction of total destruction. The Conference had not acted specifically on the question of destroying \$5 and \$10 notes locally; it had only reached the majority judgment that that should not be done "at this time," leaving the question open for further consideration at a later date.

It was suggested, in connection with the possibility of destroying higher-denomination Federal Reserve notes at the Reserve Banks, that at some point the Board might want to take the matter up with the Chairmen of the Federal Reserve Banks.

C. Basic Review of Requirements for Eligible Paper.

Mr. Scanlon, Chairman, Committee on Discounts and Credits, said that Howard H. Hackley, General Counsel for the Board, had advised him by letter dated May 21, 1963, that a draft revision of Regulation A eliminating all provisions relating to "eligibility" in conformity with the proposed legislation was still under consideration by the Board's staff. A meeting was held several weeks ago by members of the staff and Mr. Hackley is hopeful that a tentative regulation will be ready for consideration by the Board within the next two or three weeks.

After discussion, it was the consensus of the Conference that Chairman Irons bring this matter before the Board to urge expediting the matter as much as possible.

After comments by Mr. Scanlon, Chairman Martin stated that the Board was planning to give consideration to a proposed draft revision of Regulation A early in July.

6/18/63

-11-

Handling of securities. Mr. Wayne referred to the Board's letter to Chairman Irons of June 11, 1963, requesting the views and comments of the Presidents' Conference with respect to the practicality and possible desirability of adopting a book-entry procedure for handling Government securities held by Reserve Banks for member banks instead of actually issuing the securities and holding them in the vaults. He stated that this question had been referred for study to the Committee on Fiscal Agency Operations and inquired whether there would be any objection to taking appropriate steps to obtain views from the auditing standpoint.

It was indicated that there would be no objection.

The meeting then adjourned.


Secretary