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Minutes for October 16, 1963.

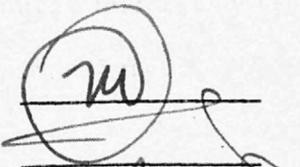
To: Members of the Board
From: Office of the Secretary

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

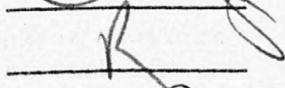
It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

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.

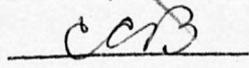
Chm. Martin



Gov. Mills



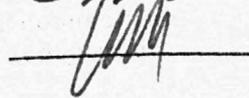
Gov. Robertson



Gov. Balderston



Gov. Shepardson



Gov. Mitchell

Minutes of the Board of Governors of the Federal Reserve System
on Wednesday, October 16, 1963. The Board met in the Board Room at
10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Mills
Mr. Robertson
Mr. Mitchell

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Solomon, Director, Division of
Examinations
Mr. Hexter, Assistant General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Furth, Adviser, Division of International
Finance
Mr. Kiley, Assistant Director, Division of
Bank Operations
Mr. Smith, Assistant Director, Division
of Examinations
Mr. Leavitt, Assistant Director, Division
of Examinations
Mr. Mattras, General Assistant, Office of
the Secretary
Mr. Young, Senior Attorney, Legal Division

Circulated or distributed items. The following items, copies
of which are attached to these minutes under the respective item num-
bers indicated, were approved unanimously:

	<u>Item No.</u>
Telegram to the Federal Reserve Bank of New York approving a gold loan to the Central Bank of Costa Rica.	1
Letter to the Federal Reserve Bank of St. Louis with regard to a request by the Department of Justice for certain information in connection with tax litigation involving a State member bank. <u>1/</u>	2

1/ Attached to these minutes as Item No. 6 is a memorandum
relating to the consideration of this matter.

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With reference to Item No. 1, Governor Mills referred to the procedures followed relative to the handling and approval of applications for gold loans. He suggested that the procedures and documentation might be rather elaborate in view of the small amount of risk implicit in such loans, as contrasted with the System's foreign currency operations. In the discussion that followed, however, Governor Mills made it clear he would not consider it in conformance with the statute for the Board to grant authority to the New York Reserve Bank to make such loans. He was not suggesting any particular change at this time in the gold loan procedures, but he felt that, in accordance with the trend of the times, the Board perhaps could properly afford to give slightly less attention to them.

Mr. Furth then withdrew from the room.

Report on competitive factors (Houston, Texas). There had been distributed a draft of report to the Comptroller of the Currency on the competitive factors involved in the proposed consolidation of Texas National Bank of Houston, Houston, Texas, and The National Bank of Commerce of Houston, Houston, Texas.

The report was then approved unanimously for transmittal to the Comptroller; the conclusion read as follows:

A consolidation of Texas National Bank of Houston, Houston, Texas, and The National Bank of Commerce of Houston, Houston, Texas, would eliminate a substantial amount of competition and significantly increase the size of the area's second largest bank. This proposal would have a strongly adverse effect on competition.

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In this connection, it was noted that the Federal Reserve Bank of Dallas had concluded that the proposed consolidation would stimulate and enhance competition and that the resultant effects would be beneficial to the competitive phases of banking in Houston. A suggestion was made that the Bank's report, which reached a conclusion opposite to that of the Division of Examinations, be used by the Division of Examinations in conjunction with the report approved by the Board as a medium for discussion with the staff of the Federal Reserve Bank of Dallas regarding elements that should appropriately be weighed in reaching judgments on the competitive factors involved in proposed mergers and consolidations. It was understood that this would be done.

Report on S. 1200 and S. 2226 (Item No. 3). There had been distributed a memorandum from the Legal Division dated October 15, 1963, with regard to a request from the Senate Banking and Currency Committee for reports on S. 1200 and S. 2226, bills that would authorize the Federal Housing Administration to compensate mortgagors for structural defects in insured homes. A draft of reply was attached to the memorandum.

S. 1200 would permit a mortgagor of a 1-to-4 family dwelling insured by the FHA to file a claim within three years of the insurance of such a mortgage for the reasonable costs of correcting structural or other major defects, and would authorize the Commissioner of FHA to require the builder or seller of such property to post a bond to

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provide indemnification in the event the Commissioner was required to pay the mortgagor the reasonable costs of correcting such defects. S. 2226 differed from S. 1200 in that reimbursement would not be limited to claims filed during the initial three-year period; and it would not require bonds to be posted by builders. In this connection, it was noted that at the present time FHA frequently had to bear the cost of repairing deficiencies, but only if the original home owners had been displaced and had lost their equity.

Questions raised by the bills included the extent of the coverage to be provided; the difficulty of administering such a program; the increase in risk that the FHA would assume; the effect on the popularity of FHA loans among builders; and the interpretation that might be given to some of the language in the bills, such as "other major defects" and "to render the dwelling safe and habitable."

The draft letter would advise that the Board had no information that would indicate the extent to which the Government would be committed in the event either of the bills were to pass, although it seemed evident that such action would effect a substantial change in the concept of the purposes of FHA. The draft letter would also call attention to the broad scope of some of the language in the bills, which could conceivably permit compensation for defects not necessarily attributable to shortcomings in construction.

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In discussion, Mr. Cardon suggested that it might be desirable to revise the letter somewhat to note that the primary purpose of the FHA program had been to provide improved financing for home owners (rather than to say, as in the draft letter, that the primary purpose had been to "protect the institution supplying the mortgage funds"). He also suggested that the Board might want to consider saying that since the subject matter of the two bills did not directly concern the functions and responsibilities of the Federal Reserve System, the Board had no special information on which to base comments on the proposed legislation, which appeared to contemplate a fundamental change in the FHA program.

Governor Mills expressed doubt as to whether the Board could appropriately restrict itself to saying the minimum. The Board had at one time administered a regulation relating to real estate credit, and member banks were active investors in FHA-insured mortgages. Therefore, he felt that the Board had a responsibility in the field and should state an opinion on the proposed legislation. After making certain suggestions with respect to the draft letter, he expressed the view that it would be desirable to have the letter redrafted and brought before the Board again.

It was pointed out, on the matter of timing, that the Banking and Currency Committee had indicated that it desired to have all reports submitted in advance of hearings on the two bills that were scheduled to begin tomorrow.

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Governor Mitchell suggested that the Board's competence related to financing rather than inspection. The draft letter seemed to him generally appropriate: it tended to cast some doubt on the proposed legislation without putting the Board in a position of condemning it. In his opinion, this was a satisfactory posture. He added that at each session of Congress many bills are introduced on which the Board is not in a position to exercise professional judgment. He doubted that the Board was in a position of expressing a judgment as to the appropriate nature of inspection of FHA-insured properties or as to the sanctions that should be imposed in the event of faulty construction.

Governor Mills, in reply, commented that over a period of many years the Board had expressed positions on proposed amendments and revisions of national housing legislation. The Board had not just passed over such matters as pertaining to a field in which it had no interest or responsibility.

Question was raised by Governor Robertson as to whether the Board might not take essentially a position that it saw no reason to object to the bills. This led to a discussion of the extent to which the enactment of such legislation would appear to involve an expansion of Government activities in this field and an expansion of the limits of Governmental financial responsibility. Comments were made, among others, to the effect that the need for such legislation might be

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lessened through administrative tightening of FHA appraisal and inspection practices.

Chairman Martin then inquired whether it would be acceptable to the Board if certain suggestions for changes in the letter that had been made earlier by Governor Robertson and Mr. Cardon were adopted and if the general tone of the letter was to the effect that the Board claimed no particular competence to pass on the subject matter of the bills.

Governors Robertson and Mitchell indicated that they would be agreeable to such an approach. However, Governor Mills stated that he would like the record of this meeting to reflect his view that the Board was shirking a responsibility. It was too bad that the matter had come before the Board so hurriedly, but he felt that there was within the Board's staff a competence of analysis and judgment that would enable the Board to express itself on this type of legislation.

Thereupon, Governor Mills' adverse views having been noted, approval was given to a letter to Chairman Robertson of the Senate Banking and Currency Committee in the form attached as Item No. 3.

Messrs. Cardon, Hexter, O'Connell, Leavitt, Young, and Mattras then withdrew from the meeting.

Examination of St. Louis Reserve Bank. There had been circulated to the Board the report of the examination of the Federal Reserve Bank of St. Louis made by the Board's examining staff as of April 26, 1963, along with the usual accompanying memoranda.

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At the request of the Board, Mr. Smith commented on the information developed through the examination, and his comments were followed by a general discussion during which Governor Mills indicated that he thought he detected in this examination report, as in other recent reports, a growing looseness in the administration of operating responsibilities. He considered it important, if this was so, that the Board's examinations be even more thorough and adequately followed up. Aside from incidents that had been referred to by Mr. Smith, he mentioned the loss of certain coupons (for which reimbursement had been made by the Bank's insurer), along with overs and shorts in the difference account traceable to the check collection function.

Governor Mills also commented that he had reviewed this particular report of examination some time ago. He understood that revised procedures recently approved by the Board would result in cutting down on the time in bringing the examination reports up for Board discussion. He noted that it had also been agreed that the Board's letters of instruction to the Federal Reserve Banks (S-letters) pertaining to expenditures should be reviewed to determine whether they comprised adequate directives for the Reserve Banks and for the examiners in their scrutiny of Reserve Bank expenditures.

It was stated by Messrs. Solomon and Smith that the revised procedures for processing the examination reports had now been placed in effect and that a memorandum on the procedures followed by the

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examiners in scrutinizing expenses had been drafted and would be available to the Board shortly.

With reference to Mr. Smith's earlier comments regarding certain suggestions that had been made by the Board's examiners relative to audit procedures at the St. Louis Bank, Mr. Solomon pointed out that the techniques used by the Board's examining staff had been extended to include reviews of audits of the Reserve Banks as conducted on occasions other than at the time of Board examinations. Through this revision of procedure, the examiners were able to get a better picture of the typical conduct of the audit function. The fact that, as a result, the number of comments and suggestions passed on to the General Auditors was likely to be greater did not necessarily mean that there had been any deterioration of the conduct of the audit function at a particular Bank.

Examination of Cleveland Bank. There had been circulated to the Board the report of examination of the Federal Reserve Bank of Cleveland made by the Board's examining staff as of May 23, 1963, along with the usual accompanying memoranda.

At the request of the Board, Mr. Smith reviewed various information developed through the examination, including in his remarks comments on problems encountered in the check collection function at the head office, as previously discussed by the Board and covered in correspondence with President Hickman.

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In response to a request for observations of the Division of Bank Operations on developments relating to the Cleveland check collection function, Mr. Kiley noted that the problems having to do with that function had received attention in recent months not only from the Division of Bank Operations but also the Board's examining staff and the Reserve Bank's General Auditor. It was indicated in correspondence from President Hickman that the management of the Bank also was giving close attention to the difficulties involved, but the change in the senior staff responsibility for this function had been made so recently that the results could not yet be fully appraised. The General Auditor had called attention to a high incidence of clerical errors, which pointed to weaknesses at the floor supervisory level. Apparently the National Cash Register electronic check-processing equipment, acquired on a lease basis, had been creating rather substantial operating problems, but it seemed that the Reserve Bank had not yet made a firm decision in this respect. The Boston Reserve Bank had encountered similar difficulty with the same equipment and had decided on a change. Mr. Kiley expected to be in Cleveland in the near future, and he indicated that he would check on reasons for deferral of a decision by that Bank on replacement of the equipment.

With reference to the possible erection of a new Cincinnati Branch building, Governor Mills commented that his reading of the

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examination report indicated that the Board's examiners gave a good standing to the present building and its adaptability for expanded operations. A great amount of money had been spent on the present building, he observed, and the Reserve Bank had taken a long-term lease on property used for a security court, which apparently was not adaptable to use for other purposes. Therefore, if the building were sold, the Reserve Bank might continue to be bound by the lease. He felt that all of these factors should be followed closely by the Board in its consideration of proposals for the construction of a new building.

Content and review of reports of examination. Governor Robertson suggested that it would seem advisable, in the interest of achieving better liaison, if the Chief Federal Reserve Examiner, Mr. Schaeffer, were brought to Washington from time to time during the course of a year to present to the Board comments on examinations of Federal Reserve Banks similar to those now presented to the Board by Mr. Smith.

It was understood that steps would be taken toward the implementation of this suggestion.

Governor Mitchell reiterated the opinion he had expressed on previous occasions that the reports of examination did not provide adequate coverage on the administration of the discount window. As he saw it, the main point of examining the discount function was to look into the borrowing activities of specific banks, and he found

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in the reports of examination no adequate basis for appraising the examiner's findings as to whether or not the function was being properly administered. In the most recent report of examination of the Chicago Reserve Bank, for example, it appeared that there might have been two or three cases of abuse of the discount privilege, but in his judgment the report did not adequately or fully document the examiner's findings.

It was understood that the Division of Examinations would discuss the subject with Governor Mitchell with a view to defining and providing the type of information that was desired with respect to the administration of the discount function.

Governor Mitchell also suggested that from time to time, when reports of examination of Reserve Banks dealt with items of special interest such as the problems encountered in the check collection function at Cleveland, the President of the Reserve Bank concerned be asked to meet with the Board for full discussion of the problem. This procedure should not be followed in connection with every examination of a Reserve Bank; only when there were subjects of more than routine interest that deserved clarification. One example might be the borrowings of certain Seventh District member banks that possibly involved abuse of the discount privilege; it was his thought that discussion with President Scanlon regarding this matter should be profitable.

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As to the construction of new Reserve Bank buildings, Governor Mitchell expressed concern that perhaps insufficient attention was being given in the planning process to relative space requirements for various functions in the future, particularly in light of prospective developments in the use of electronic equipment. For example, he could envisage relatively smaller space requirements for the check collection function, in contrast to prospective needs for the currency function. Such factors might also be applicable to consideration of the need for additional branches, as in the Seventh District. It might be desirable to have a fairly substantial array of "listening posts," insofar as they would contribute to raising the stature of the System, and possibly the currency-handling function might be more widely dispersed. In other operations, however, current developments seemed to suggest, if anything, a consolidation of operations.

In light of Governor Mitchell's comments in this respect, Mr. Kiley spoke briefly at the invitation of the Board on factors typically taken into account by the Division of Bank Operations in discussions with Reserve Banks concerning proposed new building projects. He indicated that in the future factors such as mentioned by Governor Mitchell perhaps could be given somewhat more emphasis in such discussions, but a vital question in considering projects of this kind involved how far planning should be expected to extend into the future. Most of the recent building projects had been planned on

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the basis of looking ahead about 10 or 15 years; longer-range planning increased the area of uncertainty. At the same time, projects planned on the basis of accommodating prospective needs for some 10 or 15 years had occasionally proved to provide insufficient space for expanding operations within a relatively short period of time.

Following further discussion along these lines, the meeting adjourned.

Secretary's Notes: Acting in the absence of Governor Shepardson, Governor Robertson today approved on behalf of the Board the following items:

Letter to the National Foreign Trade Council, Inc., New York, New York, advising that James K. Nettles, Economist, Division of International Finance, had been designated to attend the Fiftieth National Foreign Trade Convention, to be held in New York City, November 18, 19, and 20, 1963.

Letter to the Federal Reserve Bank of Richmond (attached Item No. 4) approving the appointment of Don W. Johnson as assistant examiner.

Letter to the Federal Reserve Bank of Richmond (attached Item No. 5) approving the designation of Irvin P. Alley, Jr., Thomas G. Wyatt, Aubrey M. Fletcher, and Daniel J. Coli as special assistant examiners.

Governor Robertson also noted today on behalf of the Board memoranda from the respective Divisions advising that applications for retirement had been filed by the following persons, effective the dates indicated:

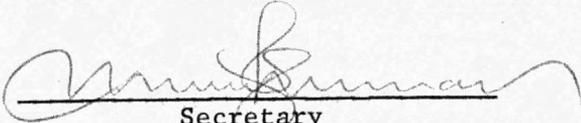
Gordon P. Johnson, Messenger, Board Members' Offices, effective at the close of business October 31, 1963.

Andrew S. Mackenzie, Assistant Federal Reserve Examiner, Division of Examinations, on the basis of disability, effective at the close of business October 25, 1963.

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John J. Blash, Carpenter-Operating Engineer, Division of Administrative Services, on the basis of disability, effective at the close of business November 30, 1963.


Secretary

TELEGRAM
LEASED WIRE SERVICEItem No. 1
10/16/63BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

October 16, 1963.

SANFORD-NEW YORK

Your wire October 10. Board approves granting of loan on gold up to a total of \$2 million by Federal Reserve Bank of New York to the Banco Central de Costa Rica on the following terms and conditions:

- (a) To be made up to 98 per cent of the value of gold bars set aside in your vaults under pledge to you;
- (b) To mature in three months with option to repay at any time before maturity, the advances to be made in multiples of \$500,000 and the repayments in multiples of \$100,000;
- (c) To bear interest at the discount rate of your Bank in effect on the date on which such loan or loans are made; and
- (d) To be requested and made at any time during a period of 30 days beginning with the date of the Banco's acceptance of your terms and conditions.

It is understood that the usual participation will be offered to the other Federal Reserve Banks.

(Signed) Merritt Sherman

SHERMAN

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

Item No. 2
10/16/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 16, 1963.

Mr. O. O. Wyrick, Vice President,
Federal Reserve Bank of St. Louis,
St. Louis, Missouri. 63166

Dear Mr. Wyrick:

This acknowledges your letter of October 7, 1963, enclosing a letter from the Fort Worth office of the Tax Division, Department of Justice, dated September 26, 1963, addressed to former Vice President Kroner of your Bank. The Department's letter refers to a pending taxpayer's refund suit entitled Arkansas Bank and Trust Company v. United States, Civil No. 989 (DC WD Arkansas), and requests certain information relating to the action by the Arkansas Bank and Trust Company in September 1959 in leasing land located in Hot Springs, Arkansas, upon which it subsequently constructed a new banking house. The Department presents four questions, the answers to which it suggests might be obtained from your Bank's files. Your letter sets forth the information contained in the Bank's files that appears to be responsive to the Department's questions, and you request the Board's advice on the extent to which such information should be made available to the Department.

The information drawn from your Bank's files and set forth in subparagraphs (1) through (4) of your October 7 letter constitutes unpublished information of the Board subject to the restrictions against disclosure contained in section 261.2 of the Board's Rules Regarding Information. The Board is authorized under these Rules to make available to the Department of Justice, as an agency of the United States, information for use where necessary in the performance of its official duties. Upon consideration of the Department's request, in relation to the apparent use for which it is intended, the Board authorizes disclosure by your Bank of information of the nature and in the manner following:

- (1) The information as set forth in your subparagraph numbered (1).
- (2) The information as set forth in your subparagraph numbered (2), substituting for the word "acquisition", the words "the leasing". This change is believed to reflect more precisely

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. O. O. Wyrick

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the proposal presented by the bank in 1959, namely, the leasing of a site upon which its banking house would be erected.

(3) The information as set forth in your subparagraph numbered (3).

(4) It is the Board's view that the opinion expressed in your subparagraph numbered (4), while constituting an appropriate supervisory judgment under other circumstances, would be gratuitous in the present circumstances, and would be less responsive than the alternative reply hereafter suggested. It seems advisable that at this time, some ten years prior to the date at which the bank may exercise the option to purchase, no determination should be made as to whether or not the bank should, when permitted under its lease arrangement to do so, exercise its option to purchase the land. Such a judgment would have to await analysis of the bank's financial position at that time, viewed in the light of its then existing investment in fixed assets. A present determination in this regard, based upon the bank's current investment in fixed assets, could differ substantially from a judgment that might be made ten years hence. Further, depending upon the carrying value of the bank's fixed assets at the date upon which it may wish to exercise the purchase option, it is possible that any decision to purchase the land and any action taken to effectuate that decision could be taken without the matter being subject to the Board's approval under section 24A of the Federal Reserve Act.

Accordingly, it is suggested that the following reply might be appropriately transmitted in response to the Department's question last presented:

"(4) Under section 24A of the Federal Reserve Act, a State member bank may not invest in bank premises without the approval of the Board of Governors of the Federal Reserve System if the aggregate of its investment in bank premises will exceed the amount of its capital stock. Inasmuch as there is no reasonable basis upon which a present judgment can be made as to the relation which the bank's investment in bank premises will bear to its capital stock at such time as, under the terms of its existing lease, it may exercise its option to purchase, we believe inappropriate an expression of opinion as to reasons, if any, why the bank 'must or must not exercise its option to purchase the land. . . .'"

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. O. O. Wyrick

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It is understood that the authorization herein given does not contemplate making available to the Department in any form the Bank's files from which the information that is authorized to be disclosed is obtained.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 3
10/16/63

OFFICE OF THE CHAIRMAN

October 16, 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 for reports on two bills: S. 1200, which would authorize the payment of certain claims for structural or other major defects in homes covered by Federal Housing Administration insured mortgages, and to require indemnification bonds in the cases of certain new construction under Federal Housing Administration insured mortgages; and S. 2226, which would authorize the Federal Housing Commissioner to make expenditures to correct substantial defects in one- to four-family dwellings covered by mortgages insured under the National Housing Act, or to compensate home owners for such defects.

While the Board has no special competence to pass judgment on the desirability of this legislation and has no information that would indicate the extent to which the Government would be committed in the event either of these bills were enacted, it seems evident that such action would effect a substantial change in the primary purpose of the FHA program, which has always been to provide improved financing for home owners.

The Board suggests that in your consideration of the two bills you may wish to note that each, as drafted, could be construed so as to permit compensation for defects not necessarily attributable to shortcomings in construction. Such an interpretation, it is understood, would be contrary to the basic purpose of the legislation.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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

Item No. 4
10/16/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 16, 1963

CONFIDENTIAL (FR)

Mr. John L. Nosker, Vice President,
Federal Reserve Bank of Richmond,
Richmond, Virginia 23213.

Dear Mr. Nosker:

In accordance with the request contained in your letter of October 7, 1963, the Board approves the appointment of Don W. Johnson as an assistant examiner for the Federal Reserve Bank of Richmond, effective today.

It is noted that Mr. Johnson is indebted to Bank of Orangeburg, Orangeburg, South Carolina, a nonmember bank. Accordingly, the Board's approval of the appointment of Mr. Johnson is given with the understanding that he will not participate in any examination of that bank until his indebtedness has been liquidated.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.



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

Item No. 5
10/16/63

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 16, 1963.

Mr. John L. Nosker, Vice President,
Federal Reserve Bank of Richmond,
Richmond 13, Virginia.

Dear Mr. Nosker:

In accordance with the request contained in your letter of October 7, 1963, the Board approves the designation of Irvin P. Alley, Jr. and Thomas G. Wyatt as special assistant examiners for the Federal Reserve Bank of Richmond for the purpose of participating in examinations of State member banks.

The Board also approves the designation of the following employees as special assistant examiners for your bank for the purpose of participating in examinations of State member banks except those listed opposite their names:

Aubrey M. Fletcher	-The Bank of Virginia Richmond, Virginia
Daniel J. Coli	-State-Planters Bank of Commerce and Trusts Richmond, Virginia

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.



Item No. 6
10/16/63

Memorandum on request of Justice Department
for information on a tax case

The Board had received a letter dated October 7, 1963, from the Federal Reserve Bank of St. Louis enclosing a letter dated September 26, 1963, from the Tax Division of the Department of Justice concerning the building program of Arkansas Bank and Trust Company, formerly Arkansas Trust Company, Hot Springs, Arkansas. The letter from the Justice Department indicated that a tax case was pending involving the transaction whereby the member bank took possession of property located at Malvern and Broadway Streets in Hot Springs, on which the taxpayer constructed a new banking office. Possession of this property was obtained by a lease agreement with option to purchase, dated September 15, 1959. The Justice Department was informed that the taxpayer had to obtain authorization from the Board of Governors for the expenditure of funds in construction of the new banking facility. Some correspondence between the Reserve Bank and the member bank's officers had been made available to the Justice Department by the member bank, but it went back only to the spring of 1960. The Reserve Bank was asked to review its file for answers to the following questions: (1) contacts, if any, between representatives of the Reserve Bank and the member bank prior to September 1959, respecting the acquisition of a site for a new banking facility; (2) whether representatives of the Reserve Bank voiced any opinion or objection to the member bank respecting its acquisition of a site (or the manner of acquisition) on which to locate the new banking facility; (3) whether the member bank, after entering into the lease-option agreement of September 15, 1959, made any representations to the Reserve Bank regarding its intention to exercise the option to purchase at a later date; and (4) whether there was any reason (from the regulatory point of view) why the bank must or must not exercise its option to purchase the land on which the banking facility was located.

The letter from the Reserve Bank pointed out that the Board, by letter dated May 27, 1960, approved the member bank's request for permission to make an investment in bank premises exceeding its capital stock. The Reserve Bank's files showed: (1) that the Reserve Bank was advised of the member bank's preliminary plans concerning a new banking house at a meeting on September 23, 1959; (2) that the Reserve Bank did not object to acquisition of a site for a new facility; the subject of purchase was not raised; (3) the subject of exercise of the option was not raised; the Reserve Bank understood that it could not be exercised until the expiration of a 15-year period. The Reserve Bank's letter indicated that it felt that exercise of the option would result in an investment in fixed assets that would be heavier than presently desirable.

The Reserve Bank requested advice from the Board as to the extent that information from its files should be made available to the Justice Department.

There had been distributed a draft of reply to the Reserve Bank that pointed out that the information drawn from the Reserve Bank's files constituted unpublished information of the Board subject to the restrictions against disclosure contained in the Board's Rules Regarding Information, Submittals, and Requests, and that the Board was authorized under these Rules to make available to the Department of Justice, as an agency of the United States, information for use where necessary in the performance of its official duties. The letter would authorize disclosure by the Reserve Bank of information along the lines suggested in the Reserve Bank's letter with one principal exception. An opinion that the exercise of the option would result in an investment in fixed assets heavier than presently desirable would seem gratuitous in the present circumstances. A present determination in this regard could differ substantially from a judgment that might be made about 10 years hence, when the bank would be able to exercise the option to purchase. Further, it was possible that any action to purchase the land could, at such time, be taken without the need for Board approval under section 24A of the Federal Reserve Act. It was suggested, therefore, that the Reserve Bank advise the Department of Justice that inasmuch as there was no reasonable basis upon which a present judgment could be made as to the relation which the member bank's investment in bank premises would bear to its capital stock at such time as the member bank could exercise its option to purchase, an expression of opinion as to reasons, if any, why the bank must or must not exercise its option to purchase the land would be inappropriate. The proposed letter to the Reserve Bank would make clear that the authorization given in it did not contemplate making available to the Justice Department in any form the Bank's files from which the information authorized to be disclosed was obtained.

At the Board's request, Mr. O'Connell reviewed in some detail the considerations apparently involved in the tax case, the questions on which information was sought by the Justice Department, the answers proposed to be given by the Reserve Bank, the alternative suggestion as to one of these answers, and the other provisions of the proposed letter to the Reserve Bank. He indicated that the draft letter was concurred in by the Division of Examinations and had been discussed with General Counsel Dunne of the Federal Reserve Bank of St. Louis.

At the conclusion of Mr. O'Connell's comments, Chairman Martin expressed the opinion that the proposed letter constituted an appropriate reply, and there was no expression of a different view by any of the other members of the Board. Accordingly, the letter was approved unanimously.