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Minutes for January 9, 1964

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

M

Gov. Mills

[Signature]

Gov. Robertson

CCB

Gov. Balderston

[Signature]

Gov. Shepardson

[Signature]

Gov. Mitchell

[Signature]

Gov. Daane

[Signature]

Minutes of the Board of Governors of the Federal Reserve System on Thursday, January 9, 1964. 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. Mitchell
 Mr. Daane

Mr. Sherman, Secretary
 Mr. Kenyon, Assistant Secretary
 Mr. Young, Adviser to the Board and Director,
 Division of International Finance
 Mr. Noyes, Adviser to the Board
 Mr. Molony, Assistant to the Board
 Mr. Fauver, Assistant to the Board
 Mr. Hackley, General Counsel
 Mr. Farrell, Director, Division of
 Bank Operations
 Mr. Solomon, Director, Division of
 Examinations
 Mr. Hexter, Assistant General Counsel
 Mr. Hooff, Assistant General Counsel
 Mr. Kiley, Assistant Director, Division
 of Bank Operations
 Mr. Leavitt, Assistant Director, Division
 of Examinations
 Mr. Mattras, General Assistant, Office of
 the Secretary
 Mr. Young, Senior Attorney, Legal Division
 Mr. Eckert, Chief, Banking Section, Division
 of Research and Statistics

Report on competitive factors (Syracuse-Lacona, New York). A report to the Comptroller of the Currency on the competitive factors involved in the proposed merger of The First National Bank of Lacona, Lacona, New York, into The Merchants National Bank & Trust Company of Syracuse, Syracuse, New York, was approved unanimously for transmittal to the Comptroller. The conclusion read as follows:

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Virtually no competition exists between The First National Bank of Lacona and The Merchants National Bank & Trust Company of Syracuse, nor are there small banks situated near Lacona which would appear to suffer adverse competitive effects from consummation of a merger of these two banks.

Effectuation of the proposed merger would not appear to have unfavorable competitive effects.

Loans to executive officers. There had been distributed a memorandum from the Legal Division dated December 27, 1963, with regard to a ruling by the Comptroller of the Currency (published in the Federal Register on December 24, 1963) on loans by national banks to their executive officers. The memorandum noted that the Comptroller's ruling on this subject was much less definite than his rulings, published at the same time, to the effect that capital debentures constitute capital stock or surplus for the purpose of calculating the lending limits of national banks and that business corporations may have savings accounts in national banks despite the contrary provisions of Board Regulation Q, Payment of Interest on Deposits. However, the tone of the Comptroller's ruling was such as to convey the impression that a national bank could lend to its officers more freely than permitted by Board Regulation O, Loans to Executive Officers of Member Banks. The memorandum noted that section 22(g) of the Federal Reserve Act forbids any member bank to extend credit to any "executive officer" of the bank in an amount exceeding \$2,500 and authorizes the Board to define the term "executive officer." The Legal Division felt that while no immediate action by the Board was necessary, the Board might conclude that, in its responsibility

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to carry out the provisions of the law, it wanted to take some action to assure that member banks conformed to Regulation O in making loans to executive officers. Thus, the Board might wish to amend Regulation O to require every member bank to report to the Federal Reserve every loan to an officer in excess of \$2,500, with such information regarding the nature of the borrower's functions as the Board might specify, through a prescribed report form or otherwise. However, even if it were ascertained that a national bank was making loans in violation of section 22(g) and Regulation O, the Board's only recourse (other than calling the matter to the attention of the Comptroller of the Currency, the Secretary of the Treasury, or Congressional committees) would be to direct the Comptroller to institute a proceeding for the termination of the franchise of the bank concerned, under the sixth paragraph of section 2 of the Federal Reserve Act.

In commenting on the matter, Mr. Hexter said the Division of Examinations was of the view that a reporting program such as outlined in the memorandum would be a complex thing to administer. On the other hand, in the absence of such a program it was not likely that the Board would have much information on possible violations by national banks. Of course, even if such a program were undertaken and it were ascertained that national banks were making loans to executive officers that the Board regarded as prohibited by the statute and Regulation O, the process of following through would involve difficulties.

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Governor Balderston suggested that the nub of the matter was the degree of enforcement by examiners of the Comptroller as contrasted with examiners of the Federal Reserve Banks. Presumably, the Federal Reserve examiners would continue to enforce the regulation that the Board had in effect, while the Comptroller's examiners might be guided by the tone of his interpretation. If there was a difference in the attitude of the two sets of examiners, this was something the Board could hardly control except in a way that it would dislike, namely, to suggest to the Federal Reserve examiners that they be as lenient as the national bank examiners.

Mr. Solomon noted that Federal Reserve Banks had been receiving inquiries on this matter. He suggested that it might be helpful to them to receive something in the nature of the Legal Division's memorandum so that they could have the benefit of the flavor of it.

Governor Mills expressed the view that this was a matter that could be left alone for the present, except possibly to give some minimum guidance to the Federal Reserve Banks. The situation was made difficult by the fact that there was a question as to whether the present maximum on loans to executive officers should not be raised, but this did not mean that there should be a change in the definition of executive officer unless the Board should decide to make such a change. This was a matter that the Board must consider thoroughly at some time, and then possibly issue some more extensive memorandum to the Federal Reserve Banks. It seemed likely that questions would be raised with

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the Comptroller concerning his interpretation and that he would answer them publicly. If his answers dealt with the definition of executive officer and were at variance with the Board's definition, there would be an opportunity at that time for the Board to reply.

Governor Robertson expressed disagreement, saying that he did not think the Board should let something like this drop. He proposed writing a letter to the Comptroller that would point out that the Board had exclusive authority to define the term "executive officer," that it had done so, and that it would expect compliance by national banks. The letter would also say that if the Comptroller had views on the subject, he should submit them to the Board. If necessary, the Board's letter could be released to the press.

Governor Shepardson expressed the opinion that the Board was being pushed more and more to the point where some of these matters would have to be answered. Up to now the Board had endeavored to avoid open conflicts to the extent possible, but if the Comptroller continued to issue interpretations that the Board regarded as incompatible with the underlying statute, at some point the Board would have to take a stand. However, he was not certain whether this was the place to take such a stand. He realized the difficulty, in a situation of this kind, of trying to get enforcement. At some stage, an open statement of Board position might help to focus attention on the difficulties involved and lead to some kind of basic action to resolve them, but he was not prepared to say that this was the point to draw the line.

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Governor Mitchell indicated that he had some difficulty with the Legal Division's memorandum because it seemed to present an issue without setting forth clearly the means of resolving the issue. The idea of having all member banks report loans to officers seemed to put a burden on them that was rather unfair. If, in the Board's judgment, the Comptroller's interpretation raised a substantive issue in terms of the definition of an executive officer, it would appear desirable to take the matter up with the Comptroller. On the other hand, if the Comptroller's interpretation was so vague as to create difficulty in taking a stand on it, or if there was any indication that the Comptroller's position was well taken, it would seem inappropriate to pursue the matter.

Mr. Hackley commented that if the Board should issue the statement currently under consideration on capital debentures, and since it had already issued a statement on corporate savings deposits, the public might wonder why the Board did not issue a statement on the matter of loans to executive officers. However, it was more difficult to comment on this statement because it was rather vague and hardly presented substantive issues. If anything, it was more in the nature of a statement that might be misleading to banks and the public, because of the tone of the language.

Governor Mills urged delay and caution, saying that he did not regard the issue here involved as a fundamental one. Rather than to take issue with the Comptroller at this particular time, he felt that

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it might be better to await another opportunity to take a stand on some matter of more critical importance.

Governor Daane said he had nothing to add to the thoughts already expressed. He had considerable sympathy with Governor Robertson's position, but some reservations as to whether this was a sufficiently important matter to pursue vigorously. Therefore, he wondered whether the matter could not be allowed to pass unnoticed.

Chairman Martin said he saw merit in the thought that the Board should delay on this matter and concentrate on other issues of more fundamental importance.

Mr. Solomon raised again the question whether it would be advisable to send the Legal Division's memorandum to the Federal Reserve Banks for internal guidance, but members of the Board expressed some doubt as to whether the memorandum would afford the Banks too much guidance.

Governor Balderston indicated that he shared the view that this was not a matter of sufficient importance to pursue actively, and he felt it would be difficult to issue a document that would be of particular help to Reserve Bank examiners. Accordingly, he reached the same conclusion as Governor Mills.

There followed further discussion of possible alternatives, with Governor Robertson restating the reasons why he felt a letter should be sent to the Comptroller along the lines that he had previously mentioned. Other members of the Board indicated either that their thinking was along the lines expressed by Governor Mills or that they

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would resolve their doubts in favor of deferring to the judgment of Chairman Martin in this matter. Accordingly, it was understood that no action would be taken by the Board at this time on the matter of the Comptroller's interpretation.

Reserve Bank budgets for first half of 1964 (Item No. 1). There had been distributed a memorandum from the Division of Bank Operations dated December 17, 1963, regarding Reserve Bank budgets for the first half of 1964. This matter had been discussed at the meeting on December 18, 1963, at which time the Board deferred action on the budgets. The Banks were advised that the budgets were still under consideration, that as to day-to-day expenses they could operate under the respective budgets as submitted, but that no commitments for unusual projects were to be undertaken until the Board acted upon the budgets.

Following a review by Mr. Kiley of the highlights of the budgets as submitted, Governor Mitchell noted that the budgets were a little difficult to compare from one Bank to another because the base periods were still not comparable. The staff, however, was in process of attempting to bring about uniformity among the Banks in this regard. The budgets, he thought, provided a lot of information about what was going on at the respective Reserve Banks. As to the check collection function, though, the situation was still quite cloudy because during the period of transition to electronic equipment costs were continuing to rise at some Banks. At the present time interpretation was rather difficult. He also felt that on the basis of six-month budgets more

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progress could be made in reducing the number of unfilled positions. This matter might be pursued with the Banks, along the same lines that it had been pursued in connection with the Board's budget.

Governor Mitchell also recalled that at the earlier discussion of the budgets, some questions had been raised about expenses for activities incident to the 50th anniversary of the Federal Reserve System. Mr. Kiley responded that a wire had been sent to all Reserve Banks asking for further information, but that the replies thus far received did not add too much to the information already available. Several Banks had indicated that their expenses would be minimal, while the expenses contemplated by others that had reported on this matter were mostly in the nature of adding an anniversary note to activities that would have been contemplated anyway.

Governor Shepardson raised the question whether publications of the Board and of individual Reserve Banks, in connection with the 50th anniversary, might tend to duplicate or overlap each other, and there was some discussion of this point from which it appeared that the activities contemplated in this area did not appear to be too extensive.

On a somewhat broader question, however, Governor Mitchell expressed the view that the Federal Reserve System was running the risk of criticism for duplication of activities, particularly in the area of publications. It might be difficult to justify the carrying on of work at more than one Reserve Bank on the same type of project.

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Governor Balderston commented that each Reserve Bank tended to direct its publications principally to persons in its own area. He sounded a note of caution against taking any steps that might tend to curb initiative or imagination.

Governor Daane indicated that he shared some of the concern expressed by Governor Mitchell about vulnerability for duplication of activities, thinking particularly of the expense involved in the preparation of materials designed for publication.

Chairman Martin noted that this was perhaps the price of a decentralized System. A different kind of system might be devised that would save a certain amount of money, but substantial values would be lost.

Governor Robertson indicated that he agreed with Governors Mitchell and Daane insofar as he shared their feeling that there should not be various people working independently on the same type of project when a matter of System-wide interest was involved.

After further discussion, Chairman Martin suggested that the coordination of publications might be a matter that the Board would like to discuss at some point with the Reserve Bank Presidents.

Mr. Noyes recalled that some years ago there was consideration of a System committee on publications to review materials that could be published by the System as a whole and given nation-wide distribution. At present there was no particular procedure for coordination, except for the review of Federal Reserve Bank monthly review articles by the

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Board's staff; this did not impose on individual Reserve Banks a required review of other publications. As a practical matter, Banks sometimes submitted proposed publications to members of the Board's staff for suggestions, but they were under no requirement.

Mr. Young noted that the program referred to by Mr. Noyes had been set up to encourage a greater degree of coordination in publishing papers, but that the Federal Reserve Banks had tended generally to bypass this particular mechanism.

In further discussion, Governor Daane suggested that some of the Reserve Banks were expending undue effort on monthly review articles to the detriment of research work on more fundamental matters.

Governor Balderston suggested that when articles were prepared that were good enough to deserve attention, the System might want to consider a mechanism for providing additional distribution and publicity for them, and along somewhat the same lines Governor Mitchell suggested the possibility of a System publication on a cooperative basis that would encourage the development for nation-wide publication of articles on serious research projects. In this way the talent available within the System might be directed to more profitable endeavors.

At this point Chairman Martin mentioned that he had recently received consent from Dr. Erwin Canham, Chairman of the Federal Reserve Bank of Boston, to head up a committee to review the problem of System publications, and other members of the Board indicated that they regarded this as a forward-looking development.

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Reverting more specifically to the Reserve Bank budgets for the first half of 1964, Governor Mitchell observed that the budget of the Federal Reserve Bank of Minneapolis contained provision for an expenditure of \$12,000 for a 50th anniversary meeting for Ninth District bankers, and he inquired as to whether any Board policy existed in regard to the holding of such meetings. This led to some discussion of the evolution of such meetings at the Minneapolis Reserve Bank, including the questions raised by the Board at one point and the trend that had been observed in recent years toward concentration on program content and elimination of extraneous activities.

At this point Governor Mills stated that, as he had indicated when the budgets for the first half of 1964 were previously under discussion, he would abstain from voting on them, because he felt that the present budget procedures were inadequate and did not give the Board an opportunity to review the contemplated expenditures of the Federal Reserve Banks in sufficient detail. In response to a question, he said his suggestion would be that the Board revert to the budget procedures that had been followed previously for many years.

Chairman Martin then called upon Mr. Farrell for a comparison of the previous and present budget procedures, and the latter pointed out that previously the Reserve Bank budgets had been prepared on a functional basis. The Banks began to prepare their budgets around the first of August, at which time they had a record of actual expenses for only the first six months of the year. A period of approximately

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18 months from August of the one year to December of the following year then had to be projected. A main reason for suggesting a change in the budget procedures was that the budgets, as previously prepared, tended to give an appearance of currency which in fact was not realized. In casting the budgets so far in advance, it was found that many events took place after the budgets were made up and therefore were not reflected in the budgets. The only follow-up was through the budget expenditure reports, in which the Banks advised the Board when they had made expenditures not provided for in their budgets, often at some period in the rather distant past. Further, the functional alignment brought in, in several instances, parts of the responsibilities of several different departments. The general conclusion was reached that all of this work was not worth the effort being put into it. The degree of currency that one might gather from a reading of the budgets was not actually there.

Governor Mills recalled that at times in the past detailed information had been available to the Board in the area of expenditures for such things as bank and public relations. He felt the Board had a responsibility to scrutinize those expenditures and pass judgment upon them.

Mr. Farrell responded that the Board had had a series of discussions with the Federal Reserve Banks on the subject of membership dues and contributions. At one time the Banks were asked to present a statement of policy, and the Board submitted a counter-proposal.

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Finally the Board issued a letter saying that this matter had received detailed consideration, that it was believed the Reserve Banks understood the Board's position, and a uniform statement of policy would not appear to serve the purpose. There was no reason, however, Mr. Farrell added, why the Board could not be provided, if it so desired, with periodic listings of membership dues and contributions or other types of discretionary expenditures.

Mr. Farrell also said that the Board had never had an opportunity to observe developments department by department through the budget process. The research function, for example, involved an amalgamation of various departmental activities. If the Board desired, however, it would be possible to adopt a procedure that would provide a detailed discussion of each department in each Bank.

Governor Mitchell expressed the view that the present budget procedures enabled the Board to see the forest rather than the trees. If the Board was interested in how much money was being spent to entertain people or how much money was being spent on membership dues, for example, it could issue a letter to the Reserve Banks specifying certain rules and let that be followed up by the examiners at the time of their examinations. At present, the budgets gave an idea of total expenditures and the changes that were contemplated from what currently was being done. The budgets were tied closely enough to the current rates of operation to be highly realistic.

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Governor Balderston referred to the listings of membership dues and contributions that had been requested by the Board for several years, and it was noted that if such information was again desired by the Board, that would have to be the subject of a special request to the Federal Reserve Banks. Such a request would not necessarily have to be tied in with the budget procedure. Governor Balderston then said that he tended to agree with Governor Mills that in several areas of discretionary expenditures the Board should be kept fully informed. In this connection there was some discussion of the information that had been requested from the Reserve Banks recently by Chairman Patman of the House Banking and Currency Committee concerning Reserve Bank expenditures in certain categories. It was indicated that the members of the Board were interested in seeing copies of the material being furnished by the Banks.

The budgets of the respective Federal Reserve Banks for the first half of 1964 were then accepted as submitted, Governor Mills abstaining for the reasons he had mentioned. A copy of the letter sent to the Federal Reserve Bank of Boston pursuant to this action is attached as Item No. 1. The letters sent to the other Reserve Banks were similar in form.

Capital notes and debentures (Item No. 2). Pursuant to the understanding at the Board meeting on January 8, 1964, there had been distributed a revised draft of a statement dealing with the legal aspects of the interpretation dated December 17, 1963, and published in the Federal Register for December 24, 1963, in which the Comptroller of the

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Currency ruled that the proceeds of capital notes, capital debentures, or other similar obligations issued by a national bank, if subordinate in right of payment to the prior payment in full of all deposit liabilities, could be included in the aggregate amount of the bank's unimpaired capital stock and unimpaired surplus funds in computing the limitations on loans prescribed by section 5200 of the U. S. Revised Statutes, which section, with certain exceptions, prohibits a national bank from lending to any one borrower an amount in excess of 10 per cent of the bank's "capital stock" actually paid in and unimpaired and 10 per cent of its unimpaired "surplus fund."

There had also been distributed a draft statement dealing with policy considerations in the use of capital notes and debentures by banks.

The discussion at this meeting indicated that the members of the Board felt that more work needed to be done before any statement was issued on the policy aspects of the use of capital notes and debentures. At the same time it was the feeling that there should be no further delay in the issuance of a statement on the legal aspects of the matter. Several suggestions for changes in the legal statement were advanced by members of the Board and by Mr. Hackley, following which the issuance of a statement in the form attached as Item No. 2 was approved unanimously. It was understood that work would continue on the development of a policy statement and that consideration also would be given to the possibility of preparing an article exploring the subject in some depth that might be published in the Federal Reserve Bulletin.

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All of the members of the staff then withdrew from the meeting and the Board went into executive session.

Following the meeting the Secretary was informed that during the executive session the following actions were taken:

OECD assignment. Consideration was given to a memorandum from Mr. Young, Adviser to the Board and Director, Division of International Finance, dated December 12, 1963, and a memorandum from the Division of Personnel Administration dated December 31, 1963, regarding the question of filling the position of Director of the National Accounts and Statistics Branch of the Organization for Economic Cooperation and Development. It was suggested in Mr. Young's memorandum that Charles A. Yager, Chief of the Government Finance Section in the Division of Research and Statistics, be made available for this assignment, which would extend from approximately the end of February 1964 to the end of February 1966. The memorandum from the Division of Personnel Administration outlined three alternative plans under which Mr. Yager might be made available:

- (1) that he would resign as an employee of the Board for the period of this assignment and become a foreign service reserve officer, with the understanding that at the end of the assignment the Board would stand ready to reemploy him, with all salary emoluments that he would have received if he had remained a Board employee during this tour of duty;
- (2) that Mr. Yager be loaned on a reimbursable basis to the Organization for Economic Cooperation and Development; and (3) that Mr. Yager be retained as a Board employee, with salary (including any progress

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increases or general pay increases) and fringe benefits that would accrue to him if he remained physically with the Board. Under the third alternative, Mr. Yager would be paid allowances by the Board in the same amount as foreign service officers would be paid on duty station in the Paris area. Reimbursement would be expected from the Organization, to the extent that reimbursement could be made by it, for salary and allowances. The Organization would pay transportation for Mr. Yager and his family as well as the cost of transporting his household goods. For various reasons, the Division of Personnel Administration recommended the third alternative plan.

After discussion, the Board authorized making Mr. Yager available for the assignment on the basis of the third alternative plan and approved this plan for use in connection with any future assignments from the Board's staff to fill the position of Director of the National Accounts and Statistics Branch. It was understood that Governor Shepardson would bring back to the Board a recommendation with respect to detailed arrangements for the assignment of Mr. Yager, within the scope of the general arrangements authorized at this meeting.

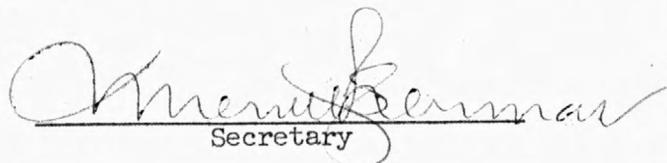
Directors Day. It was agreed that the annual program for newly-appointed Federal Reserve Bank and Branch directors would be held this year on Thursday, March 19, preceded by a dinner on Wednesday, March 18, with letters of invitation to be sent to the directors about the middle of February.

The meeting then adjourned.

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Secretary's Note: Pursuant to the recommendation contained in a memorandum from the Division of Research and Statistics, Governor Shepardson today approved on behalf of the Board acceptance of the resignation of Peter I. Berman, Summer Research Assistant in that Division, effective at the close of business February 14, 1964.


Secretary

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

Item No. 1
1/9/64



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 9, 1964.

Mr. George H. Ellis, President,
Federal Reserve Bank of Boston,
Boston, Massachusetts. 02106

Dear Mr. Ellis:

The Board of Governors has reviewed and accepts
the budget of the Federal Reserve Bank of Boston for the
first half of 1964, as submitted with your letter of
November 13, 1963.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.



Item No. 2
1/9/64

For immediate release

January 9, 1964.

CAPITAL NOTES AND DEBENTURES

AS "CAPITAL", "CAPITAL STOCK", OR "SURPLUS"

The Board of Governors has been presented with the question whether capital notes or debentures issued by banks, that are subordinated to deposit liabilities, may be considered as part of a bank's "capital stock", "capital", or "surplus", for purposes of various provisions of the Federal Reserve Act that impose requirements or limitations upon member banks.

A "note" or "debenture" is an evidence of debt, embodying a promise to pay a certain sum of money on a specified date. Such a debt instrument issued by a commercial bank is quite different from its "stock", which evidences a proprietary or "equity" interest in the assets of the bank. Likewise, the proceeds of a note or debenture that must be repaid on a specified date cannot reasonably be regarded as "surplus funds" of the issuing corporation.

Federal law (12 U.S.C. 51c) expressly provides that the term "capital", as used in provisions of law relating to the capital of national banks, shall mean "the amount of unimpaired common stock

plus the amount of preferred stock outstanding and unimpaired." In addition, when Congress in 1934 deemed it desirable to permit certain notes and debentures - those sold by State banks to the Reconstruction Finance Corporation - to be considered as "capital" or "capital stock" for purposes of membership in the Federal Reserve System, Congress felt it necessary to implement that objective by a specific amendment to section 9 of the Federal Reserve Act. These plain evidences of Congressional intent compel the conclusion that, for purposes of statutory limitations and requirements, "capital" notes and debentures may not properly be regarded as part of either "capital" or "capital stock".

Accordingly, under the law, capital notes or debentures do not constitute "capital", "capital stock", or "surplus" for the purposes of provisions of the Federal Reserve Act, including, among others, those that limit member banks with respect to loans to affiliates, purchases of investment securities, investments in bank premises, loans on stock or bond collateral, deposits with nonmember banks, and bank acceptances, as well as provisions that limit the amount of paper of one borrower that may be discounted by a Federal Reserve Bank for any member bank.