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Minutes for February 10, 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 _____

Gov. Mills _____

Gov. Robertson _____

Gov. Balderston _____

Gov. Shepardson _____

Gov. Mitchell _____

Gov. Daane _____

Minutes of the Board of Governors of the Federal Reserve System on Monday, February 10, 1964. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman 1/
Mr. Balderston, Vice Chairman
Mr. Mills 2/
Mr. Robertson 1/
Mr. Shepardson
Mr. Mitchell
Mr. Daane

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Miss Carmichael, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Fauver, Assistant to the Board

Messrs. Brill, Holland, Koch, Garfield, Partee, Williams, Altmann, Axilrod, Eckert, Keir, Weiner, and Wernick of the Division of Research and Statistics

Messrs. Furth, Sammons, Katz, Wood, Gekker, Gemmill, Irvine, and Maroni of the Division of International Finance

Economic review. The staff of the Division of International Finance commented on international financial and business conditions, with special reference to the U. S. balance of payments, and the staff of the Division of Research and Statistics presented information relating to the domestic economy.

During the latter presentation Chairman Martin and Governor Robertson withdrew from the meeting and Governor Mills entered the room.

1/ Withdrew from meeting at point indicated in minutes.
2/ Entered meeting at point indicated in minutes.

After discussion based upon the reports presented, all members of the Board's staff withdrew except Messrs. Sherman, Kenyon, Young, Fauver, and Brill and Miss Carmichael, and the following entered the room:

Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Solomon, Director, Division of Examinations
Mr. Johnson, Director, Division of Personnel Administration
Mr. Hexter, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Hricko, Senior Attorney, Legal Division
Mr. McClintock, Supervisory Review Examiner, Division of Examinations

Circulated item. The following item, a copy of which is attached to these minutes under the item number indicated, was approved unanimously:

	Item No.
Letter to The Connecticut Bank and Trust Company, Hartford, Connecticut, approving the establishment of a branch at 445-457 West Main Street, Norwich.	1

Application of Rhode Island Hospital Trust Company (Items 2 and 3). Pursuant to the decision reached at the meeting on February 4, 1964, there had been distributed a proposed order and statement reflecting approval of the application of Rhode Island Hospital Trust Company, Providence, Rhode Island, to acquire the assets of Wickford Savings Bank, Wickford, Rhode Island.

After discussion, during which certain changes in the statement were suggested and agreed upon, the issuance of the order and statement was authorized subject to those changes being made. Copies of the documents, as issued, are attached as Items 2 and 3, respectively.

Messrs. Hricko and McClintock then withdrew from the meeting.

Reply to Chairman Fascell (Item No. 4). In accordance with the discussion at the meeting on February 7, 1964, there had been distributed a revised draft of reply to a letter dated February 3, 1964, from Chairman Fascell of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations relating to conflicting interpretations and possible duplications of supervision between the Board of Governors and the Comptroller of the Currency. Chairman Fascell had asked for comments regarding the extent to which there had been differences in interpretations of statutes and duplication of regulation between the two agencies, how the operations of the agencies had been affected, how the supervised banks had been affected, efforts that had been made to prevent such differences and duplications, and means for preventing disparate actions by the agencies.

During discussion a number of changes in the letter were suggested, principally (1) to emphasize that the chief differences that had arisen between the two agencies were based on conflicting interpretations of various provisions of the law and, in that light, (2) to delete certain possible suggestions for solving the differences, including the reference to recommendations made in the April 1963 report of the Committee on Financial Institutions that had been appointed by President Kennedy.

The letter to Chairman Fascell was then approved unanimously in the form attached as Item No. 4. It was understood that the letter

would be accompanied by a memorandum that had been prepared in the Legal Division analyzing the Comptroller's position on corporate savings deposits. It was also understood that copies of the letter to Chairman Fascell would be sent to the Chairmen of the Senate and House Banking and Currency Committees as a matter of information. 1/

Question was raised as to whether the letter should be released to the press or made available in response to inquiries regarding conflicting interpretations of the Board and the Comptroller. While some sentiment was expressed in the direction of feeling that it would be useful to make available the information in the reply, at least in response to inquiries, it was understood that such a step would not be taken until it could be determined what disposition the Legal and Monetary Affairs Subcommittee might make of the letter. It was suggested that if the Board found need for a general release, a somewhat different type of statement might be considered for that purpose.

Messrs. Young, Molony, Cardon, and Shay then withdrew from the meeting.

Outside activities and financial transactions of Reserve Bank officers and employees (Item No. 5). On the basis of discussion at the meeting on February 5, 1964, there had been distributed a revised draft of letter to the Presidents of all Federal Reserve Banks that

1/ Chairman Martin subsequently decided against sending copies of the letter to the Banking and Currency Committees.

was designed to incorporate in a single communication the Board's views concerning outside activities and certain financial transactions of Federal Reserve Bank officers and employees.

Following comments by Mr. Sherman on the changes from the earlier draft, the letter was approved unanimously. A copy is attached as Item No. 5.

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

Editorial Committee of Bulletin. The Secretary was informed later that during the executive session the Board approved the recommendation in a memorandum from Mr. Molony dated February 4, 1964, that Mr. Brill, Director, and Mrs. Sette, Chief of Economic Editing, Division of Research and Statistics, be added to the Editorial Committee of the Federal Reserve Bulletin, which currently consisted of Messrs. Molony, Young, and Noyes.

The meeting then adjourned.

Secretary

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

Item No. 1
2/10/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 10, 1964.

Board of Directors,
The Connecticut Bank and
Trust Company,
Hartford, Connecticut.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by The Connecticut Bank and Trust Company, Hartford, Connecticut, of a branch at 445-457 West Main Street, Norwich, Connecticut, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

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

Item No. 2
2/10/64

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Application of

RHODE ISLAND HOSPITAL TRUST COMPANY

for approval of acquisition of assets of Wickford Savings Bank

ORDER APPROVING ACQUISITION OF BANK'S ASSETS

There has come before the Board of Governors, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), an application by Rhode Island Hospital Trust Company, Providence, Rhode Island, a member bank of the Federal Reserve System, for the Board's prior approval of its acquisition of assets of Wickford Savings Bank, Wickford, Rhode Island. As an incident to such application, Rhode Island Hospital Trust Company has applied, under section 9 of the Federal Reserve Act, for the Board's prior approval of the establishment of a branch by that bank at the present location of Wickford Savings Bank. Notice of the proposed acquisition of assets, in form approved by the Board of Governors, has been published pursuant to said Bank Merger Act.

Upon consideration of all relevant material, including the reports furnished by the Comptroller of the Currency, the Federal

Deposit Insurance Corporation, and the Department of Justice on the competitive factors involved in the proposed transaction,

IT IS HEREBY ORDERED, for the reasons set forth in the Board's Statement of this date, that said applications be and hereby are approved, provided that said acquisition of assets and establishment of a branch shall not be consummated (a) within seven calendar days following the date of this Order, or (b) later than three months after said date.

Dated at Washington, D. C., this 10th day of February, 1964.

By order of the Board of Governors.

Voting for this action: Unanimous, with all members present.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

(SEAL)

Item No. 3
2/10/64

BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

APPLICATION OF RHODE ISLAND HOSPITAL TRUST COMPANY
FOR PRIOR APPROVAL OF ACQUISITION OF ASSETS OF
WICKFORD SAVINGS BANK

STATEMENT

Rhode Island Hospital Trust Company, Providence, Rhode Island ("Trust Company"), with deposits of $341.7 million as of June 29, 1963, has applied, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), for the Board's prior approval of its acquisition of assets of the Wickford Savings Bank, Wickford, Rhode Island ("Savings Bank"), a mutual savings bank with deposits of $4.4 million as of the same date.

Incident to such application, Trust Company also has applied, under section 9 of the Federal Reserve Act (12 U.S.C. 321), for the Board's prior approval of the establishment of a branch at the location of the sole office of Savings Bank, increasing the number of offices operated by Trust Company to 24. In addition, Trust Company has received approval to establish three other branches which are not yet operative.

Under the Act, the Board is required to consider, as to each of the banks involved, (1) its financial history and condition, (2) the adequacy of its capital structure, (3) its future earnings prospects, (4) the general character of its management, (5) whether its corporate powers are consistent with the purposes of 12 U.S.C., Ch. 16 (the

Federal Deposit Insurance Act), (6) the convenience and needs of the community to be served, and (7) the effect of the transaction on competition (including any tendency toward monopoly). The Board may not approve the transaction unless, after considering all these factors, it finds the transaction to be in the public interest.

Banking factors. - Both of the banks have satisfactory financial histories. Each has a sound financial condition, an adequate capital structure, satisfactory management, and favorable future earnings prospects. It is expected that this would be true also of the acquiring bank.

There is no indication that the powers of the banks involved are or would be inconsistent with the purposes of 12 U.S.C., Ch. 16.

Convenience and needs of the communities. - Wickford, an unincorporated community in the Town of North Kingstown on the western shore of Narragansett Bay, is 20 miles south of the city of Providence. The proposed transaction would affect only the banking needs and convenience in the Wickford-North Kingstown area, which comprises the service area of Savings Bank.*

North Kingstown's 1960 population of about 19,000 represents an increase of around 28 per cent for the preceding decade. For the same period, Wickford's population increased by 20 per cent to approximately 3,000. While the economy of Savings Bank's service area is based

* That area from which a bank obtains 75 per cent or more of its deposits of individuals, partnerships, and corporations.

largely on local retail outlets and small manufacturing concerns, North Kingstown has experienced substantial growth because of extensive military installations in the area. Industrial expansion in the area is in progress and is expected to increase.

The only commercial bank with offices in the Wickford-North Kingstown area is Industrial National Bank of Rhode Island, the State's largest commercial bank, which has one office at Wickford and two elsewhere in the service area of Savings Bank.

While leaving unchanged the number of banking offices where savings accounts can be maintained in the Wickford-North Kingstown area, consummation of the proposal would make available at the Wickford branch of Trust Company, the State's second largest commercial bank, significant banking services not available at Savings Bank. These would include checking accounts, installment and other loans, a substantially higher lending limit, and trust services. As a result, the residents of the Wickford-North Kingstown area would have the benefit of a convenient alternative source of banking services. People's Savings Bank in Providence, with a branch three miles north of Savings Bank, would remain conveniently available to those residents of the area desiring the services of a mutual savings bank.

Competition. - The effect of the proposed transaction on competition would be limited to the service area of Savings Bank. Trust Company's service area includes almost all of the State and encompasses

the service area of Savings Bank. However, there is no more than a minor amount of competition between the two banks. Trust Company's offices nearest to Wickford are at East Greenwich, seven miles north, and at Wakefield, ten miles south of Wickford; but the Industrial National Bank of Rhode Island, mentioned above, has a branch midway between East Greenwich and Wickford, in addition to a branch at Wakefield. Furthermore, mutual savings banks are not permitted under State law to offer many of the services available at commercial banks.

While the proposal does not provide for the assumption by Trust Company of the deposit liabilities of Savings Bank, it may be reasonably expected that some depositors in Savings Bank will transfer their accounts to Trust Company, rather than receive them in connection with the liquidation of Savings Bank. However, Savings Bank's deposits are equal to only about one-half of one per cent of the aggregate deposits of individuals, corporations, and partnerships in commercial banks in Rhode Island, so that any resulting increase in the size of Trust Company would not be significant.

As previously noted, the only commercial bank with offices in the Wickford-North Kingstown area is Industrial National Bank of Rhode Island, the State's largest. While effectuation of the transaction would provide residents of the area a choice of commercial banking services and thereby stimulate competition for commercial banking services in that area, it would not be expected to affect adversely People's Savings Bank in Providence, the mutual savings bank whose branch would be the only other banking office in the Wickford-North Kingstown area.

Summary and conclusion. - This proposal, which would supplant the sole office of a small mutual savings bank with a branch of the second largest commercial bank in the State, would provide to the customers of the former a convenient alternative source of commercial banking services. The transaction would be expected to stimulate competition between the acquiring bank and the largest commercial bank in the State, since branches of the latter are now the only commercial banking offices within the relevant area, without adversely affecting the only other bank in the area, a mutual savings bank.

Accordingly, the Board finds the proposed acquisition of assets to be in the public interest.

February 10, 1964.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 4
2/10/64

OFFICE OF THE CHAIRMAN

February 13, 1964.

The Honorable Dante B. Fascell, Chairman,
Legal and Monetary Affairs Subcommittee of the
Committee on Government Operations,
House of Representatives,
Washington, D. C. 20515

Dear Mr. Chairman:

Your letter of February 3, 1964, regarding conflicting interpretations and possible duplications of supervision between the Board of Governors and the Comptroller of the Currency, relates to a subject that has become of increasing concern to the Board in recent months. In particular, you ask for comments regarding the extent to which there have been differences in interpretations of statutes and duplication of regulation between the two agencies, how the operations of the agencies have been affected, how the supervised banks have been affected, the efforts that have been made to prevent such differences and duplications, and the means for preventing disparate actions by the agencies.

A number of differences have arisen between the Comptroller of the Currency and the Board of Governors over the last year or so, but a brief indication of the nature of some of the major differences may suffice.

In September 1963, the Comptroller issued a revision of his Investment Securities Regulation which, among other things, purports to authorize national banks and State member banks to underwrite revenue obligations issued by public authorities and corporations. Such obligations have not been exempted by Congress from the Federal statutory prohibition against the underwriting of securities by national banks and State member banks, and Congress has not authorized the Comptroller to grant any such exemptions. The Board has informed State member banks that the only securities exempt from the limitations and restrictions of the statute are those specified therein. (Federal Reserve Bulletin, November 1963, pp. 1505-1510)

The Comptroller has ruled that "Federal funds" transactions are not subject to the limitations prescribed by the national banking laws on loans made by national banks. The Board of Governors,

however, has held that, for purposes of statutory limitations administered by it, so-called "sales" and "purchases" of Federal funds actually constitute loans and borrowings. (Federal Reserve Bulletin, September 1963, p. 1238)

In an interpretation published in December 1963, the Comptroller ruled that notes and debentures that are subordinated to deposit liabilities may be regarded as a part of a national bank's "capital stock and surplus" in applying statutory limitations on loans by national banks to their customers. Since a note or debenture obviously does not constitute "stock" or a part of the "surplus" of a bank, as Congress has explicitly recognized, the Board has taken the position that notes and debentures may not be treated as part of a bank's capital stock or surplus for purposes of limitations contained in the Federal Reserve Act that are based upon the amount of a member bank's capital stock and surplus. (Federal Reserve Bulletin, January 1964, p. 9)

In another interpretation published in December 1963, the Comptroller intimated in nonspecific language that national banks are not bound by the definition of the term "executive officer" set forth in the Board's Regulation O, implementing the statutory prohibition against the making of loans to their executive officers by all member banks, both national and State. This Regulation was issued by the Board pursuant to express authorization contained in section 22(g) of the Federal Reserve Act, including specific authority to define the term "executive officer"; and, unless and until the Regulation is changed by the Board, the present definition of an "executive officer" contained therein is, of course, applicable to all member banks.

Recently, the Comptroller published a proposed regulation that would require national banks to obtain the Comptroller's approval before engaging in any "international operation", including the establishment of foreign branches and investment in foreign banking or financing corporations. Congress has specifically authorized the Board of Governors to permit and regulate the activities of national banks as well as State member banks in this field; and the Comptroller's proposed regulation inevitably would result in duplication of supervision and the prospect of conflicting interpretations in still another area. A copy of the Board's letter to the Comptroller regarding his proposed regulation was transmitted to you on January 29, 1964.

A major conflict between the Comptroller and the Board has related to the question whether member banks of the Federal Reserve System (national banks and State member banks) may properly accept savings deposits from business corporations. Time certificates and time deposit, open accounts, are, of course, presently available to

such corporations; the question is whether they may also have savings deposits in member banks. Since this has been one of the most publicized of recent conflicts, a more extended discussion of this matter may serve to exemplify the difficulties that stand in the way of preventing and resolving divergent views between the two agencies under present circumstances.

In 1935, Congress expressly authorized the Board to define "savings deposits" for purposes of payment of interest on deposits by member banks and for purposes of reserve requirements of such banks. Pursuant to this authority, the Board, in its Regulations Q and D, has, since February 1, 1936, defined savings deposits to exclude deposits of business corporations. Nevertheless, in an interpretation published in December 1963, the Comptroller expressed the view that the Board has no authority to preclude the maintenance of savings deposits by any class of depositor, and that, therefore, national banks may accept such deposits from business corporations. The Board has recently reaffirmed its position that, under its present Regulations, such deposits may not be classified or treated as savings deposits by either national or State member banks. (Federal Reserve Bulletin, January 1964, p. 9)

On January 21, 1964, the Comptroller sent to all national banks a letter enclosing a copy of his December 1963 ruling on this question, a copy of a letter to Senator Robertson, and a memorandum of his Legal Department in support of his position that the Board's authority to define savings deposits does not include authority to base such definition upon the nature of the depositor. Copies of these documents are enclosed for your information. There is also enclosed a memorandum prepared in the Board's Legal Division commenting on the documents issued by the Comptroller's Office.

The Comptroller's legal memorandum relies largely upon Board opinions prior to 1933 defining savings deposits for purposes of reserve requirements in terms of conditions of withdrawal. It ignores the all-important fact that the definition of savings deposits took on new significance after 1933, when Congress prohibited the payment of interest on demand deposits and it became necessary, for the first time, to define savings deposits in a manner that would prevent evasion of that prohibition. Any possible question as to the Board's authority in this respect was eliminated when Congress, in the Banking Act of 1935, expressly authorized the Board to define savings deposits for the purposes of section 19 of the Federal Reserve Act, relating to reserves of member banks and payment of interest on deposits by such banks. The 1935 Act also authorized the Board to issue such regulations as it might deem necessary to effectuate the purposes of section 19 and prevent evasions.

With respect to enforcement of the Board's definition of savings deposits, the Comptroller's legal memorandum argues that the provisions of section 2 of the Federal Reserve Act regarding forfeiture of a national bank's charter and liability of its directors for violations of the Federal Reserve Act apply only to national banks organized before 1913. It is difficult to believe that the Comptroller seriously contends that Congress meant thus to discriminate in favor of national banks organized since 1913. In this connection, the Comptroller's legal memorandum, on the basis of an unrelated amendment to the law, minimizes the significance of a 1943 Federal court decision expressly holding that the provisions of section 2 of the Federal Reserve Act above mentioned were applicable to a national bank organized after 1913.

Conflicts between the two agencies have resulted in a situation in which State member banks and national banks are being unequally treated in the application of provisions of Federal law that govern both categories of member banks. Obviously, it was the intention of Congress to avoid just such a situation. It is equally clear that Congress did not contemplate that national banks could be absolved from compliance with regulations of the Board of Governors, issued under express statutory authority, that are applicable to all member banks.

Over the years, until recent times, any differences of opinion that have arisen between the Comptroller's Office and the Board of Governors have generally been resolved through consultation and close cooperation between the two agencies and their staffs. The Board of Governors continues to seek to cooperate as far as possible with the Comptroller's Office, as well as with other supervisory agencies, in an effort to harmonize divergent views. Recent developments, however, have frustrated efforts to achieve such cooperation.

Divergent applications of the same provisions of law to different groups of banks are obviously unjust. In addition, they have produced a state of confusion that has become extremely serious. The Board has received letters from banks indicating their dissatisfaction and perplexity. The differences of legal interpretation between the Comptroller's Office and the Board of Governors nullify the intent of Congress that different classes of banks shall be treated alike under applicable provisions of Federal law. They tend to impair the efficient operations of the Federal bank supervisory agencies and even threaten to bring the agencies into disrepute and to undermine respect for law and the processes of Government.

Needless to say, the Board is prepared to participate in any efforts that would hold promise of achieving a reasonable resolution of the current conflicts without doing violence to the will of Congress. However, in discharging its statutory responsibilities, the Board could not, of course, accede - merely for the sake of uniformity - to actions of another agency which in the Board's opinion are contrary to law.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

LEGAL DIVISION

February 12, 1964.

Comments on Documents Issued by the Comptroller of the Currency Regarding Acceptance of Corporate Savings Accounts by National Banks

On January 21, 1964, the Comptroller of the Currency addressed a letter to the Presidents of all national banks regarding the acceptance of savings accounts from business corporations. The letter enclosed a copy of the Comptroller's ruling on this subject published in the Federal Register for December 24, 1963, a copy of a letter from the Comptroller to Senator Robertson dated January 14, 1964, and a copy of a memorandum prepared by the Comptroller's Legal Department dated January 21, 1964.

The gist of the four documents is that the Board of Governors of the Federal Reserve System has no legal authority to define savings deposits in terms of the nature of the depositor or to enforce any such definitions in the case of national banks.

The documents are so phrased that they might seem plausible to the casual or uninformed reader. Upon analysis, however, it appears that they are based largely upon unsupported assertions, without regard for accuracy, logic, or legal considerations. The following discussion considers in chronological order the three documents enclosed with the Comptroller's letter of January 21, 1964.

COMPTROLLER'S INTERPRETATION OF DECEMBER 24, 1963

The Comptroller's initial announcement on this subject was published in the December 24, 1963 issue of the Federal Register. He ruled that national banks could accept corporate savings accounts solely on the ground that the Board's authority to define savings deposits (the first paragraph of section 19 of the Federal Reserve Act, 12 U.S.C. 461) "extends only to the terms of the deposit contract such as a description of withdrawal requirements and interest rate limitations" and that there is nothing in the law that "would preclude, or would authorize a regulation which would preclude, the maintenance of such accounts by any class of depositor."

The Board's statutory authority to define savings deposits is not subject to any limitation. Consequently, contrary to the Comptroller's statement, there is something in the law that authorizes a regulation precluding the maintenance of such deposits by classes of depositor that the Board may designate. The contention that the Board's authority to define such deposits is limited to "the terms of the deposit contract" will be considered later in discussing the memorandum of the Comptroller's Legal Department. Obviously, "interest rate limitations" are a separate matter - a consequence rather than an element of the definition of the term "savings deposit" - and are specifically covered by another provision of law.

COMPTROLLER'S LETTER TO SENATOR ROBERTSON

The first paragraph of the Comptroller's letter to Senator Robertson, dated January 14, 1964, makes the irrelevant statement that it is the small business corporation, rather than General Motors Corporation, that is "unfairly and seriously handicapped by the Board's discriminatory and unlawful definition of deposits by the character and general purposes of the depositor." This statement ignores (1) the fact that Congress has conferred statutory authority upon the Board (and not the Comptroller) to define savings deposits and (2) the fact that the objective of the Board's definition has been to prevent the improper use of savings deposits in order to circumvent the statutory prohibition against payment of interest on demand deposits.

The third paragraph of the letter states that a memorandum of the Comptroller's Office "will discuss" not only the Board's authority to define savings deposits but also the Board's "vague threats of massive retaliation" and the Board's lack of authority to enforce "acceptance of its unlawful definition of savings deposits by an action against the bank's directors or by an assessment of penalties for reserve deficiencies". This statement is an illustration of an argumentative technique that is not susceptible of rational response: a categorical assertion that the adversary is wrong, i.e., that the Board's definition of savings deposits is "unlawful", without citing any reasonable basis for the assertion.

The Comptroller's statement also contains implications that are wholly unwarranted. The Board has said nothing that threatens "massive retaliation" against national banks; it mentioned only a provision of law that makes violations of the Federal Reserve Act a ground for forfeiture of the charter of a national bank. Nor has the Board suggested that it might, or could, take any "action" against the directors of a national bank for damages resulting from violations of the Act; the Board in its published statement of December 26, 1963,

merely referred to a provision of law that makes a director of a national bank liable for damages sustained as a consequence of violations of the Act to which he assented.

The final paragraph of the Comptroller's letter to Senator Robertson emphatically states that the Comptroller alone is responsible for enforcement of banking laws and regulations applicable to national banks and that his examiners will not take exception to any actions that are in accordance with his interpretation of the banking laws. In other words, he will disregard regulations and interpretations of the Board under statutory provisions applicable to national banks, even though Congress has placed upon the Board the responsibility for issuing regulations to implement such provisions.

MEMORANDUM OF COMPTROLLER'S LEGAL DEPARTMENT

Definition in terms of nature of depositor. - The first five pages of the memorandum of the Comptroller's Legal Department (out of a total of 11 pages) are devoted to a review of Board opinions prior to 1933 in which the Board defined savings deposits for reserve purposes in terms of notice of withdrawal and to Board opinions between 1933 and 1935 in which the Board took the position that savings deposits should consist of funds accumulated for "bona fide thrift purposes". In the latter connection, the memorandum cites a 1934 opinion of the Board that stated that "deposits of corporations in most cases would not consist of funds accumulated for bona fide thrift purposes; but here again no general rule can be laid down. * * * With respect to firms and individuals engaged in business, the nature of the business may be important in determining this question. * * * In some instances the amount of the funds on deposit may be a factor for consideration in determining the propriety of their classification as savings deposits."

Two important points are ignored by the Comptroller's memorandum in discussing these opinions of the Board.

First, the fact that before 1933 the Board defined savings deposits solely in terms of withdrawal is understandable because the definition had significance only for reserve purposes. It was not until enactment of the Banking Act of 1933 that member banks were prohibited from paying interest on demand deposits. Since savings deposits are in practice paid on demand, although not legally payable on demand, it became important for the first time to limit the category of "savings deposits" in order to prevent evasions of the prohibition of interest on demand deposits. The Board at first

sought to do this by restricting savings deposits to funds accumulated for bona fide thrift purposes - a restriction based on a subjective test that proved difficult to administer but one that would generally exclude corporate deposits. The Board's objective, as indicated in the 1934 opinion above mentioned, was to preserve the right of small individual "savers" to obtain interest on accounts that were in practice paid on demand. In furtherance of this objective, that opinion concluded that deposits of other banks could not be classified as savings deposits - a conclusion obviously based upon the nature of the depositor.

The second point ignored by the Comptroller's memorandum is the fact that Congress, in the Banking Act of 1935, expressly authorized the Board to define "savings deposits" both for reserve purposes and for purposes of payment of interest on deposits. There was no suggestion in that Act or in its legislative history that the Board's authority was limited to the terms of the deposit contract. This is the key point in the current controversy. In net effect, the Comptroller's memorandum is based on the untenable ground that the authority given the Board by the Banking Act of 1935 to define savings deposits gave the Board no more authority than it had before the Act was passed, i.e., authority to define such deposits in terms of withdrawal.

Confusion of authority to define savings deposits with the fixing of maximum interest rates. - The Comptroller's memorandum argues that a bill introduced in Congress last year to increase deposit insurance coverage contained a provision "proposed at the request of the Board of Governors" that would have given the Board standby authority to fix maximum interest rates on time and savings deposits in accordance with the "nature * * * of the depositor", and that this indicates that the Board was uncertain as to its authority to define savings deposits in terms of the nature of the depositor.

In the first place, this provision was not proposed at the request of the Board. Some of the Board's staff, at the request of the Budget Bureau, assisted in the drafting of this and other provisions of the bill mentioned; and the Board, in June 1963, advised the Budget Bureau that it had no objections to a revised version of the bill. But the Board did not recommend or request inclusion of the provision regarding interest rates on deposits.

Even if the Board had requested authority to fix maximum interest rates according to the nature of the depositor, this action would in no way have suggested doubt as to the Board's authority under present law to define savings deposits in terms of the nature of the depositor. The two matters are completely unrelated. Present law expressly limits the criteria for fixing different maximum rates to maturities, conditions of withdrawal, location, and discount rates;

and the Board has recognized that it may not base different rates on the nature of the depositor. The Board's authority to define savings deposits is quite a different matter; that authority is not subject to any statutory qualification.

The "privilege" of maintaining savings deposits. - The distorted and misleading nature of some of the arguments contained in the Comptroller's memorandum is illustrated by a statement on page 7 of the memorandum that the Board's position as to corporate savings accounts "enables the Board to extend the 'privilege of maintaining savings deposits' to individuals of unlimited means and to nonprofit corporations, associations, or other organizations possessing vast fortunes while it refuses such 'privilege' to a small one man business corporation." The statement implies that the Board has discriminated against small corporations by not according them the "privilege" of maintaining savings accounts. Actually, of course, contrary to the Comptroller's insinuation, the maintenance of a savings deposit is a "privilege", but one accorded by the law itself, since the law permits the payment of interest on such deposits even though in practice they are paid on demand. In other words, the memorandum again ignores the basic fact that the limitation prescribed by the Board as to the kinds of depositors that may have savings deposits is designed to preserve the statutory distinction between demand deposits and savings deposits in so far as payment of interest is concerned.

Moreover, the memorandum does not mention the fact that, shortly before the Comptroller's interpretation of December 24, 1963, the FDIC had proposed a series of conferences for a discussion by representatives of the FDIC, the Comptroller, and the Board of Governos of the desirability of changing the regulatory definition of "savings deposits" to make such deposits available to business corporations, either with or without appropriate limitations. Yet, before these conferences were well underway, the Comptroller (the only one of the three agencies without regulatory authority in this area) took the matter in his own hands and advised national banks that they were free to accept savings deposits from business corporations.

Enforcement considerations. - Perhaps the most absurd argument contained in the Comptroller's memorandum is that the provisions of section 2 of the Federal Reserve Act, regarding the forfeiture of the franchise of a national bank for violations of the provisions of that Act and the liability of directors of national banks for the consequences of such violations, apply only to national banks that were in existence when the Federal Reserve Act was enacted on December 23, 1913. The argument is based on the fact that, if read literally, the sixth paragraph of section 2 would require only national banks in existence on that date to comply with provisions of the Act, under penalty of forfeiture of their charters for noncompliance.

The Comptroller's memorandum concedes that there appear to be "conflicting dicta pertaining to this matter" in two Federal court decisions, but contends that any such conflict is "clearly resolved" in support of the Comptroller's position by a 1958 amendment to section 2 of the Federal Reserve Act.

One of the cases cited in the memorandum, Holman v. Cross, 75 Fed. 2d 909 (1935), involved a question of the liability of directors and officers of a national bank for damages resulting from a violation of a provision of the Federal Reserve Act (since repealed) that prohibited loans or payment of dividends while the bank was deficient in its reserves. The defendants contended that the provision of section 2 regarding liability of directors became obsolete one year after its enactment; and the court stated that this contention drew some "persuasiveness" from the fact that the paragraph of section 2 involved had been omitted from the U. S. Code. Nevertheless, the court expressly did not rule upon this contention because it found that the damages alleged had not actually resulted from a violation of the provision of law in question.

The other case cited in the Comptroller's memorandum, involving a similar question, was Michelsen v. Penney, decided in 1943 by an outstanding United States Court of Appeals. (135 F. (2d) 409). In that case, the directors of a national bank organized after 1913 were held liable for damages resulting from violations of the Federal Reserve Act. The court discussed the effect of the provisions of section 2 of the Federal Reserve Act regarding forfeiture of the franchises of national banks and the liability of their directors as a result of such violations. It concluded that only the provision requiring national banks in existence in 1913 to become members of the Federal Reserve System expired one year after the date of the Act; in other words, that the remaining provisions of the paragraph with respect to compliance with the provisions of the Federal Reserve Act, forfeiture of charter for noncompliance, and liability of directors, continued in effect. The court specifically noted that these provisions, although omitted from the U. S. Code at the time of the Holman case, had since been regularly included in the Code.

Despite this clear judicial confirmation of the continued validity of the provisions of section 2 of the Federal Reserve Act regarding the compliance by national banks with the provisions of the Act and liability of their directors for violations, the Comptroller's memorandum argues that an amendment of July 7, 1958, to the first paragraph of section 2 for the first time made the forfeiture penalty applicable to failure of national banks organized after 1913 to join the Federal Reserve System, and that the failure of the 1958 amendment

to mention the provisions regarding compliance with the Federal Reserve Act and liability of directors for damages resulting from noncompliance indicates that these provisions are still applicable only in the case of national banks organized before 1913. The argument is clearly fallacious, as indicated in the following paragraphs.

The 1958 amendment to the first paragraph of section 2 was proposed by the Board of Governors in connection with pending Alaskan and Hawaiian Statehood bills. The reason for the proposal was that, under section 19 of the Federal Reserve Act, national banks located in Alaska and other Territories or in any place outside the continental United States were not required to be members of the Federal Reserve System and that, consequently, unless the law was amended, national banks in the new States of Alaska and Hawaii would not be required, as were national banks in other States, to become members of the System. Accordingly, the law was amended to require every national bank "in any State" to become a member of the System upon commencing business or within 90 days after the admission of the State into the Union. The amendment was clearly not motivated by any understanding that national banks in the existing States were not required to become members of the System. On the contrary, the Board's letter of March 13, 1950 to the Congressional Committee considering the Statehood bills explicitly stated that "under present law, all national banks in the existing States of the Union are required to be members of the Federal Reserve System."

It seems obvious that Congress was not in any sense concerned at the time of the 1958 amendment with the question of compliance by national banks with the provisions of the Federal Reserve Act and the liability of their directors for violations of the Act. There was no need for any such concern because, as indicated in the Michelsen case, those provisions are applicable in the case of all national banks, whether organized before or after 1913.

The unsoundness of the Comptroller's argument is apparent when one realizes that it would simply mean that some national banks must comply with the Federal Reserve Act and be subject to forfeiture of their charters for failure to comply, while other national banks - those organized since 1913 - would not need to comply with the provisions of the Act. An intent to draw such an irrational and capricious distinction is not to be attributed to Congress.

As to the Board's authority to assess penalties for reserve deficiencies of a national bank because of the bank's failure to accept the Board's "prohibition of corporate savings accounts", the Comptroller's memorandum states that a review of the provisions of the Federal Reserve Act does not disclose the existence of any such

authority. Presumably, the memorandum means that there is no provision in the law that specifically mentions penalties for deficient reserves resulting from the acceptance of corporate savings accounts. This is certainly true, and the Board's published statement on this subject did not suggest that there was any such specific provision. The Board simply pointed out two incontrovertible facts: (1) that, if a national bank classified corporate accounts as savings deposits, such accounts would nevertheless be treated by the Board as demand deposits for reserve purposes, and (2) that, if any reserve deficiencies should result, the bank would be subject to penalties for such deficiencies.

The Comptroller's memorandum ends with the suggestion that the Board might seek to require compliance with its "unauthorized and unrealistic definition of savings deposits" by resorting to "arbitrary and capricious refusal to exercise affirmatively its discretionary authority in behalf of particular banks in such matters as advances, discounting, and foreign branches." There has, of course, been no statement or action of the Board that would lend the slightest support to this impugnation of the Board's integrity.

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S-1907

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 10, 1964.

Dear Sir:

This letter, which is designed to incorporate in a single communication the Board's views concerning outside activities and certain financial transactions of Federal Reserve Bank officers and employees, supersedes the Board's letters of March 24, 1948 (S-1018; FRLS #9054) and October 7, 1957 (S-1639; FRLS #9054.1). The views expressed in this letter are applicable to outside activities of all officers and full-time regular employees. Depending on the particular circumstances, they may or may not be equally applicable to individuals engaged on a consultant basis, those employed on a part-time basis, or those employed for temporary periods such as during vacations or for work on specific projects.

As an over-riding general principle, the Board continues to take the position it has held for many years: officers and employees of a Federal Reserve Bank should refrain from placing themselves in any position that might embarrass the Bank or the Federal Reserve System as a whole in the conduct of its operations or result in any question being raised as to the independence of the individual's judgment or his ability to perform satisfactorily all of the duties of his position with the System. In keeping with this concept, outside business affiliations and teaching activities should be entered into only with the approval of a Federal Reserve Bank.

The Board believes that the propriety of participation in specific outside activities can be determined effectively only after consideration by the management of a Federal Reserve Bank on the basis of the circumstances pertinent to the particular situation. It would, therefore, not be feasible for the Board to attempt to comment on all types of activities in which Reserve Bank officers and employees might be engaged. For the guidance of the Reserve Banks, however, the Board's views on certain kinds of outside activities follow:

1. The Board would ordinarily see no objection to an officer or employee of a Federal Reserve Bank maintaining a teaching connection with a recognized educational institution at the university level, particularly if such a connection would be helpful in enabling him to keep abreast of developments in his field and if it would facilitate communication between the Federal Reserve System and the academic community. Similarly, the Board would ordinarily see no objection to teaching connections with other reputable institutions of learning, especially if the curriculum bears some relationship to the functions of a Federal Reserve Bank, as in the case of the American Institute of Banking and other schools of banking. Teaching engagements should be clearly secondary and should not interfere with the performance of Reserve Bank duties. It would, of course, be inappropriate for an individual to accept payment for teaching services rendered on the Reserve Bank's time or, if out of town, when travelling expenses are paid by the Bank.

2. Participation of an officer or an employee in the preparation of material for articles or other publications utilizing information accumulated in the conduct of the affairs of a Reserve Bank should be subject to approval of the Bank. If the publication is prepared on Bank time, it would be inappropriate for the individual concerned to accept additional compensation or an honorarium. Officers or employees would not be precluded from receiving compensation or an honorarium for a publication prepared on the individual's own time, provided the Bank is fully informed and approves.

3. If an officer or employee of a Federal Reserve Bank undertakes a public speaking or similar assignment as a representative of the Bank, it is the Board's view that no additional compensation or honorarium should be accepted by the individual concerned.

4. The Board considers it inappropriate for any officer or employee of a Federal Reserve Bank to engage in speculative dealings (as distinguished from investments), whether on a margin or a cash basis, and whether in securities, commodities, real estate, exchange, or otherwise. Frequency of trading would be a significant indicator in judging whether dealings were speculative, particularly any transactions that appeared to be for the purpose of taking advantage of short-term price fluctuations, and the use of credit also would be a pertinent consideration.

5. It would be inappropriate for a member of the staff of a Reserve Bank to purchase stock of a bank or an affiliate thereof (except possibly where the actual relationship of the affiliate to the bank is remote); officers and employees occupying responsible positions and holding or acquiring stock of banks or affiliates should dispose of it as promptly as is practicable without causing undue hardship.

It is understood that all Federal Reserve Banks will continue to require officers and employees occupying responsible positions to submit periodic reports to the Board of Directors regarding outside business activities and indebtedness. The examiners of the Board of Governors continue under instruction, in connection with each examination of a Federal Reserve Bank, to review those reports and inform the Board of any situations that they feel should be brought to the Board's attention.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS