Minutes for March 11, 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 Wednesday, March 11, 1964. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman 1/
Mr. Balderston, Vice Chairman
Mr. Mills
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. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. O'Connell, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Koch, Associate Director, Division of Research and Statistics
Mr. Partee, Adviser, Division of Research and Statistics
Mr. Dembitz, Associate Adviser, Division of Research and Statistics
Mr. Furth, Adviser, Division of International Finance
Mr. Conkling, Assistant Director, Division of Bank Operations
Mr. Goodman, Assistant Director, Division of Examinations
Mr. Leavitt, Assistant Director, Division of Examinations
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Doyle, Attorney, Legal Division
Mr. McClintock, Supervisory Review Examiner, Division of Examinations
Mr. Egertson, Supervisory Review Examiner, Division of Examinations
Mr. White, Review Examiner, Division of Examinations

1/ Withdrew from meeting at point indicated in minutes.

Application of Bank of Commerce (Item No. 1). There had been distributed a draft of letter to Bank of Commerce, Newark, New Jersey, approving the establishment of a branch at 21 Commerce Street, Newark.

The letter was approved unanimously. A copy is attached as Item No. 1.

Report on competitive factors (Sharon-Sharpsville, Pennsylvania). There had been distributed a draft of report to the Comptroller of the Currency on the competitive factors involved in the proposed purchase of assets and assumption of liabilities of the First National Bank of Sharpsville, Sharpsville, Pennsylvania, by The McDowell National Bank of Sharon, Sharon, Pennsylvania.

During discussion, questions were raised by members of the Board as to the probable effect of the proposed merger on the competitive position of Merchants and Manufacturers National Bank of Sharon, and as to the service areas of that bank and the banks that would be parties to the merger.

At the conclusion of the discussion the staff was requested to review the report in the light of the questions raised prior to further consideration of the matter by the Board.

Report on competitive factors (Kalamazoo-Delton, Michigan). There had been distributed a draft of report to the Comptroller of the Currency on the competitive factors involved in the proposed purchase of assets and assumption of liabilities of The Delton State Bank, Delton, Michigan,

by The First National Bank and Trust Company of Kalamazoo, Kalamazoo, Michigan.

After a discussion during which a revision of the conclusion was agreed upon, the report was approved unanimously for transmission to the Comptroller of the Currency. The conclusion of the report, as approved, read as follows:

> The proposed purchase of assets and assumption of liabilities of Delton State Bank by First National Bank, Kalamazoo, would eliminate competition existing between the participants and would increase the volume of business held by the largest Kalamazoo bank. Because of the number of banking offices of other banks reasonably accessible to the Delton service area and also because of the number and variety of nonbank financial institutions, the proposed transaction should not affect the competitive financial situation in the area to any important extent.

Personal property leasing (H. R. 9822). There had been distributed a memorandum dated March 10, 1964, from the Division of Examinations and the Legal Division summarizing the comments of the Presidents of the Federal Reserve Banks, expressed in response to the Board's telegram of February 26, 1964, regarding H. R. 9822, a bill to prohibit banks from engaging in the business of personal property leasing. Opinions of the Presidents were varied: some felt that banks should not be precluded from leasing equipment; others expressed approval of the bill, with reservations; while the Presidents of six of the Reserve Banks took a position against equipment leasing as a bank activity, the strongest views being expressed by President Scanlon of the Chicago Reserve Bank.

The memorandum, which was submitted pursuant to the understanding at the Board meeting on February 19, 1964, commented that it would seem desirable that the same limitations apply to the leasing of personal property as apply to the lending of money. The leasing of personal property by a bank involved considerable risk, probably not significantly different from that involved in unsecured lending. Attached to the memorandum was a draft of reply to Chairman Multer of the Subcommittee on Bank Supervision and Insurance of the House Committee on Banking and Currency, who had requested the Board's views on the bill. The draft reply would state that "From your remarks on January 31 on the floor of the House, it would appear that introduction of the bill was prompted by the views set out in a letter of March 18, 1963, to the presidents of all national banks from the Comptroller of the Currency. It is understood that the Comptroller's position is that a national bank may become the owner and lessor of personal property acquired upon the specific request of and for the use of a customer and may incur such additional obligations as may be incident to becoming an owner and lessor of such property, and that such transactions do not result in obligations subject to the lending limits set forth in section 5200 of the Revised Statutes." The draft reply would then recite briefly the arguments for and against equipment leasing, note that the practice so far was not widespread and appeared to have been exercised with caution, and conclude that "In the circumstances, the Board would not favor prohibiting the purchase and leasing

of property as contemplated by the ruling of the Comptroller of the Currency as an alternative means of financing the needs of certain customers. However, at the same time the Board perceives no reason why such an alternative means of financing should not be subject to the same limitations as are applicable to the lending of money. Therefore, the Board would recommend that such transactions be made subject specifically to the basic loan limitation imposed by section 5200 of the Revised Statutes applicable to unsecured lending by national banks."

The memorandum mentioned the possibility that the proposed report might fall within the purview of the letter of March 3, 1964, from the Secretary of the Treasury to the three Federal bank supervisory agencies looking toward a maximum degree of coordination among them in the field of bank regulation; the staff view, however, was that the report on the bill was not the kind of matter contemplated by the Secretary's letter.

After introductory comments by Mr. Solomon, the early part of the discussion dealt with the question whether or not the Board's reply to Chairman Multer should be brought to the attention of the Secretary of the Treasury.

Governor Mills expressed the view that the reference in the Secretary of the Treasury's letter of March 3, 1964, to changes in "any rule, regulation or policy" did not contemplate a requested expression of views on proposed legislation; if every such report by the Board had to be cleared through a central office, Congress would lose the benefit of the Board's independent thinking.

Mr. Hackley commented that, on the basis of staff discussions of the Secretary's letter, it was believed that the letter was not intended to encompass reports on bills in Congress. Such reports might be made known to the Secretary as a matter of courtesy, but the procedure requested in his letter did not appear to extend to them.

Chairman Martin remarked that he believed, nevertheless, that it would be well for the Board to resolve any doubt in the direction of coordination. In this case, he brought out, the proposed legislation concerned national banks, and the issues involved went to the question of the basic soundness of a banking practice. It was difficult legislation, with arguments both for and against it, and an expression of mixed views could be interpreted many different ways.

Governor Daane expressed the opinion that the spirit and intent of the letter from the Secretary of the Treasury were clear. The Board, in his opinion, ought to inform the Secretary of whatever the substance of its letter turned out to be. As to substance, he was not sure whether or not the draft was the kind of letter the Board should send.

Chairman Martin commented that the Board's letter perhaps should express a more definite position. He was inclined to feel that the practice of property leasing should not be prohibited by legislation. However, President Scanlon had presented rather strongly the view that the practice was undesirable. It might be advisable for the Board to try to resolve its views and take a stronger position.

Governor Mitchell remarked that, while he did not particularly disagree with the conclusion, he believed the draft letter could be improved. The difficulty might be that the Board did not know more about the leasing practice. In response to his question as to the extent of the practice, the staff indicated that it apparently was not widespread. At the time of the September 1963 call report, only a scattering of national banks were engaged in this activity. The December call would be more informative. Further comments dealt with the mechanics of leasing transactions.

Governor Mills stated that he took a more serious attitude toward the undesirability of the practice than did some of the Reserve Bank Presidents. It was significant to him that technically proficient people in the field had given strong warnings; although those warnings were colored by self-interest, he felt they were nonetheless valid. As he saw it, leasing involved the acquisition of fixed assets in much the same way that a bank acquired bank premises. It might be contended that, since a bank might lease offices in a building it owned, leasing of other assets was similar. However, the building owned by a bank was predominantly a bank structure; banks were not allowed to own other real estate. Giving direct or indirect endorsement to this practice would promote the trend toward permitting banks to acquire fixed assets.

Governor Mitchell indicated that, as he understood it, in almost every case the bank was depending on the credit standing of the lessee

for security. It appeared to be large corporations, for the most part, that resorted to leasing arrangements, because they found a tax advantage in them. Staff comments, however, indicated that it could not be assumed that large corporations were, or would be, the principal users of the leasing arrangements.

Governor Balderston stated that his first reaction had been the same as that expressed by Governor Mills. However, after comparing the leasing arrangements with the lease-back agreements used by insurance companies, he was not sure there was a fundamental difference. Until he had pursued this line of reasoning, he had thought he was opposed to leasing activities by banks; now he was not sure.

Governors Balderston and Mitchell then suggested that the Board's reply to Chairman Multer stress the desirability of bringing leasing within the confines of the statutory loan limit, without taking a position against the practice itself.

After further discussion, the staff was requested to consider the draft reply further in the light of the views that had been expressed.

During the preceding discussion, Messrs. Broida, Assistant Secretary, and Holland, Associate Director, Division of Research and Statistics, entered the room; at its conclusion, Messrs. Fauver and Shay withdrew from the meeting.

Interest rates on time deposits. There had been distributed copies of a letter dated February 21, 1964, from the Federal Reserve

Bank of New York recommending, for reasons stated, an increase to 5 per cent, under the Board's Regulation Q, Payment of Interest on Deposits, in the maximum rates of interest payable on time deposits with a term of 90 days or more. There had also been distributed a memorandum dated March 10, 1964, from Mr. Brill attaching an analysis of the issues underlying the question of an increase in the ceiling rate, with special reference to negotiable certificates of deposit. Three alternative objectives toward which the Board might wish to direct its actions were suggested. (1) The volume of time certificates of deposit could be left to determination by bankers' decisions and competitive forces, permitting the volume to rise further if those forces led in that direction. This could be done by raising the rate on time deposits of 90 days or more from 4 per cent to a higher figure. (2) The Board might want to restrain substantial further expansion in the volume of certificates of deposit outstanding while at the same time avoiding pressure for any large reduction in outstanding certificates. This might be done by permitting a higher rate for some limited amount of time deposits, specified in relation to a bank's total deposits. (3) The outstanding volume could be contracted by permitting any further rise that might occur in the general level of short-term interest rates to exert pressure against present maximum rates on certificates of deposit.

Various considerations that seemed relevant to a choice among the foregoing alternatives were discussed in the memorandum, and on the basis

of that review the staff recommended, first, that no increase in the interest rate ceilings specified in Regulation Q be made at this time. Available market information suggested that no serious pinch on the liability structure of any appreciable number of banks was yet occurring. It was believed that the general interest rate structure was rather closely balanced at the moment, and any action to increase Regulation Q ceilings, even though permissive in nature, might well be taken by the market as a signal of higher interest rates to come, thereby leading to anticipatory upward adjustments, particularly in short-term rates.

The staff's second recommendation was that an action program be developed with respect to interest rate ceilings, for introduction at whatever time it seemed to be called for in the future by an upward move in short-term market rates. Three alternative types of action programs were suggested for consideration: (a) an across-the-board increase in maximum interest rates on all maturities of time deposits of three months or more; (b) some measure of restraint upon future bank efforts to expand their certificates of deposit by raising interest rate ceilings only on time deposits with maturities of one year or more; and (c) a substitute or supplemental provision in Regulation Q that would allow higher interest rates to be paid only on amounts of time deposits (other than savings deposits) up to, say, 10 or 15 per cent of the issuing bank's total deposits, with lower and less competitive maximum interest rates applicable to time deposits created in excess of such a limit.

The third recommendation of the staff was that an intelligence system be established to alert the Board to significant problems in the certificate of deposit area as they developed. Two types of problems in particular should be made the focus of early investigation. Those banks that were already reporting extraordinarily large certificate totals relative to their total deposits should be studied by research and examining personnel to ascertain if they were employing imprudent or undesirable methods for the sale of their certificates, if they were unduly exposed to concentrated demands for payment, and if their over-all portfolios of loans and investments were so out of balance relative to probable need for liquidity as to call for criticism. Procedures also should be established at the Reserve Banks and the Board to watch for persistent shrinkages in certificates outstanding, especially at smaller banks where the shrinkage conceivably could reflect a serious stringency as a result of existing interest rate ceilings.

At the Board's request, Mr. Brill summarized and supplemented the material that had been distributed, bringing out that the phenomenal growth of negotiable certificates of deposit, from about $1 billion at the end of 1960 to approximately $10.6 billion at the present time, created problems both for monetary policy and for bank supervision. The certificates had come to have an important influence on the structure of bank credit and, some believed, on the level of interest rates.

Messrs. Noyes and Dembitz then cited certain statistics on the growth of negotiable certificates and the number of banks whose certificates

represented a substantial percentage of deposit structure. Of all weekly reporting member banks, 238 had certificates outstanding; 133 banks had certificates outstanding equal to less than 5 per cent of total deposits, 60 banks from 5 to 10 per cent, 29 banks from 10 to 15 per cent, 11 banks from 15 to 20 per cent, and 5 banks over 20 per cent. The present interest ceiling of 4 per cent appeared to present no problem at the moment to large banks in selling certificates, but there was some evidence that secondary banks, at about the $200 million deposit level, and perhaps even tertiary banks were using various devices to circumvent the interest rate limitation.

Chairman Martin referred to the Board's action last year under Regulation Q as having been strongly influenced by a desire to allow U. S. banks to compete successfully for foreign time deposits, and asked if there was any particular problem in this respect at present. Mr. Furth responded that U. S. banks appeared to be competitive for foreign deposits at present rates; there did not seem to be reason to fear a large outflow of funds because of a differential between domestic and foreign short-term interest rates unless European rates should rise significantly.

Reference was made also to a recent survey in which the Bank Examinations Department of the Federal Reserve Bank of New York interviewed 47 member banks as to their practices regarding the use of funds obtained through the issuance of negotiable time certificates, the results of the survey seeming to suggest that the large banks issuing such certificates had used this new market instrument in a responsible manner.

Secretary's Note: Copies of a statement regarding the New York Reserve Bank's survey, dated February 28, 1964, were distributed after the meeting.

Question was raised as to whether banks were selling certificates principally to their natural customers, or whether there were predatory efforts to draw deposits away from other banks through this means. The response was that available statistics would not support any positive statement. There seemed to be no doubt, however, but that some banks were pursuing aggressive tactics in selling certificates. Those whose certificates represented 15 to 20 per cent or more of total deposits must have been buying deposits that would normally go to other banks.

The discussion also touched upon the influence of large holdings of certificates on a bank's portfolio policy; with rates up to 4 per cent being paid on such obligations, the principal investments to which banks might be expected to turn in seeking a return even fractionally higher would be mortgages and municipals, with consequent possible danger to liquidity. It was observed that the New York Reserve Bank's survey had included a question as to the relation between liquidity problems and the weight of certificates in a bank's deposit structure; of the 35 banks that responded to the question, 16 indicated that there was only an informal allocation of assets. More detailed statistics were needed to develop conclusions as to the effect of aggressive merchandising of certificates upon bank liquidity.

After further discussion, during which Chairman Martin withdrew from the meeting, general agreement was indicated with the staff view

that no immediate action was called for to adjust the maximum rates of interest permitted to be paid by member banks on time deposits. There was also agreement that steps should be taken to expand the scope of information available to the Board regarding the impact of the expanded use of negotiable certificates of deposit, along lines suggested by Mr. Brill's memorandum.

Messrs. Noyes, Brill, Holland, Koch, Partee, Dembitz, Conkling, Goodman, and Leavitt then withdrew from the meeting.

Request by bank officer. Mr. Hackley reported that an officer of Farmers and Merchants Bank of Long Beach, California, who had been indicted, along with other officers of the bank, reportedly for alleged statutory violations in connection with certain loan transactions, had asked that the Federal Reserve Bank of San Francisco issue a statement to the effect that the indictments in no way affected the soundness of the bank. The Reserve Bank had refused, on the ground that the issuance of any such statement would be inappropriate.

It was agreed, following discussion, that the Reserve Bank had acted properly in refusing the request.

The meeting then adjourned.

Secretary's Note: Pursuant to the recommendation contained in a memorandum from the Division of Administrative Services, Governor Shepardson today approved on behalf of the Board the transfer of Phyllis G. Meadows from the position of Mailing List Clerk and Flexowriter Operator to the position of Clerk-Typist in that Division, with no change in basic annual salary at the rate of $4,090, effective March 15, 1964.

Secretary

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

Item No. 1
3/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 11, 1964.

Board of Directors,
Bank of Commerce,
Newark, New Jersey.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment of a branch at 21 Commerce Street, Newark, New Jersey, by Bank of Commerce, provided the branch is established within one year from the date of this letter.

Very truly yours,

(signed) Karl E. Bakke

Karl E. Bakke,
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.)