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
Discount rates. The establishment without change by the Federal Reserve Bank of Boston on March 16, 1964, of the rates on discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

Report on competitive factors (Sharon-Sharpsville, Pennsylvania). Pursuant to discussion at the meeting of the Board on March 11, 1964, there had been distributed a revised 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 First National Bank

It was suggested at today’s meeting that the report be changed to track more closely the views expressed in a memorandum from the Federal Reserve Bank of Cleveland with respect to the competitive aspects of the proposal. There being agreement with this suggestion, the report was approved unanimously for transmittal to the Comptroller in a form in which the conclusion read as follows:

It appears that the proposed purchase would serve to increase the competition of McDowell with the larger banks represented in the service area and that no smaller bank would suffer undue or harmful competitive effects. However, the resultant bank would have 43.8 per cent of the I.P.C. deposits in the primary service area and 43.7 per cent of the loans. If the larger geographical area referred to as the General Service Area in this memorandum was considered, McDowell would have 30.6 per cent of I.P.C. deposits and 29.5 per cent of the loans.

These substantial concentrations coupled with the significant amount of competition between the institutions which would be lost as a result of the purchase lead us to conclude that the competitive effects of the transaction must be considered adverse.

During the foregoing discussion Messrs. Cardon, Legislative Counsel, and Holland, Associate Director, Division of Research and Statistics, entered the room.

Reports on H. R. 8499 and S. 2223. There had been distributed a memorandum from the Legal Division dated March 13, 1964, with reference to requests from the House Committee on Interstate and Foreign Commerce and the Senate Committee on Banking and Currency for reports on H. R. 8499 and S. 2223, identical bills providing for the regulation of collective
investment funds maintained by banks. The bills would in effect permit banks to offer to the public the equivalent of mutual fund shares, but--unlike mutual funds--these would not be subject to the Securities Act of 1933, the Investment Company Act of 1940, or the regulations of the Securities and Exchange Commission under the two Acts. According to provisions of the bills, the Comptroller of the Currency would have exclusive regulatory authority over bank "mutual funds," but enforcement authority would be divided among the three Federal bank supervisory agencies.

By way of background, the memorandum pointed out that section 11(k) of the original Federal Reserve Act authorized the Board of Governors to regulate the trust powers of national banks. Around 1927, banks began to establish what were known as "common trust funds" wherein a bank commingled, for investment purposes, the funds of two or more individual trusts for which it acted as trustee. In 1936, after common trust funds were held subject to the Federal income tax on corporations, Congress provided tax exemption (now section 584, Internal Revenue Code) for common trust funds established and operated by banks in conformity with regulations of the Board of Governors. As a result, although the Board had statutory authority to regulate the trust powers of national banks only, State-chartered banks--whether or not members of the Federal Reserve System--were obliged to comply with the Board's Regulation F, Trust Powers of National Banks, in order to gain tax exemption for their common trust funds.
Section 11(k) of the Federal Reserve Act was repealed on September 28, 1962, and the authority to regulate trust activities of national banks was transferred to the Comptroller of the Currency. The Internal Revenue Code was accordingly amended to provide tax exemption for common trust funds operated under the applicable regulations of the Comptroller.

Throughout the time trust powers of national banks were under the jurisdiction of the Board, the definition of "common trust fund" in Regulation F paralleled the definition set forth in section 584(a) of the Internal Revenue Code, i.e., a "fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian." Banks were deterred from engaging in the equivalent of a mutual fund business by the fact that Regulation F confined participation in common trust funds to "bona fide" trusts.

When the Board's authority over trust powers of national banks was transferred to the Office of the Comptroller of the Currency, the provisions of Regulation F were incorporated in the Comptroller's Regulation 9. Subsequently, on February 5, 1963, the Comptroller published a notice that it was proposed to amend Regulation 9 to authorize collective investment not only for common trust funds as defined in section 584 of the Internal Revenue Code but also for (1) funds received by a bank pursuant to personal retirement plans of self-employed persons granted tax advantages by the Smathers-Keogh Act of 1962, and (2) funds maintained
by a bank for the collective investment of funds contributed thereto by 
the bank in its capacity as "fiduciary, other than as trustee, executor, 
administrator or guardian."

Thereupon, the Securities and Exchange Commission informed the 
Comptroller and others that the proposals to broaden the powers of banks 
in the field of collective investment funds would present questions 
under the Federal securities laws. Nevertheless, the Comptroller's 
amended Regulation 9, effective April 5, 1963, included as funds author-
ized to be invested collectively those of Smathers-Keogh plans and those 
contributed by the bank in its capacity as "managing agent."

On February 5, 1964, the Federal Register carried amendments to 
Regulation 9 which (1) eliminated from the definition of managing agent 
the reference to the legal relationship of agent and principal, and (2) 
limited managing agency funds held by a national bank which may be 
invested collectively to those in which the agreement creating the agency 
expressly provides that the moneys are received by the bank "in trust."
These amendments were apparently made to clear the way for a subsequent 
ruled by the Internal Revenue Service that managing agency accounts 
wherein the contract specifies that the bank receives the funds "in trust" 
will be accorded the tax relief provided by section 584 of the Internal 
Reserve Code.

On May 20, 1963, a hearing was held by the Legal and Monetary 
Affairs Subcommittee of the House Committee on Government Operations on
the subject "Common Trust Funds -- Overlapping Responsibility and Conflict in Regulation." The Committee report recommended to the House Committee on Interstate and Foreign Commerce that "it direct its attention to the consideration of legislation which would specifically exempt common trust funds of managing agency accounts and Smathers-Keogh plans by national banks from the Federal securities laws, and provide for such protections for investors therein as may be deemed necessary." Subsequently H. R. 8499 and S. 2223 were introduced in the House and Senate.

The bills raised two policy questions: (1) whether banks should be permitted to engage in activities that were substantially equivalent to the operation of mutual funds, and (2) if so, what agency or agencies should have regulatory authority.

Following consideration of each of these questions, the Legal Division found no persuasive reason for excluding banks from the mutual fund business and, if banks entered that field, the Division concluded that the funds should be subject to the Federal securities laws administered by the Securities and Exchange Commission. It was recommended that the Board oppose enactment of both bills, principally on the grounds that it considered the Securities and Exchange Commission to be the appropriate regulatory agency. It was also recommended that the Board provide the Committees with specific comments on the apparent shortcomings of the bills for consideration in the event that the Committees should decide to report favorably on the proposed legislation. A draft of letter to
the two Committees, together with a detailed statement covering short-comings of the bills, were attached to the memorandum.

At the Board's invitation, Mr. Sanders commented on the two bills, his remarks being based mainly on the Legal Division's memorandum.

Governor Mills expressed agreement with the approach taken so far as it went. He was of the opinion that if Congress in its wisdom permitted banks to expand into the mutual trust fund area, the administrative agency should be the Securities and Exchange Commission. As he had expressed himself on earlier occasions, however, he also thought that it would be a serious mistake for the Congress to permit banks to expand in this area and, therefore, he believed the Board's reply should go on to express opposition to the legislation as a matter of principle. As history revealed, when commercial banks formerly engaged in the securities business, serious abuses resulted. To allow banks to engage in the securities business and also to permit them to advertise this type of service would be in his judgment a major step backward. If banks operated in the mutual fund area through the vehicle of the common trust fund, and if banks made unwise investment decisions that were challenged by participants on the ground of negligence in operation of trusts, this could affect the confidence of the public in the banking system. Another consideration that was claiming more attention as time went on involved the voice in bank management that trust departments were acquiring. In his judgment the whole problem deserved the attention of the Congress.
The Board should not become an accessory to the development of an undesirable situation.

Governor Robertson stated that he did not think the Board should go at this time into the question whether banks should be engaging in activities that were substantially equivalent to the operation of mutual funds because the Board had at an earlier date passed up an opportunity to take a position on this point. However, he thought the Board's reply should express the view that the Securities and Exchange Commission should be the regulatory agency. Governor Robertson then suggested a number of changes in the wording of the letter along the line of pointing out the results that might be expected to occur if responsibility in this area devolved upon the Federal bank supervisory agencies.

Chairman Martin expressed agreement with the changes suggested by Governor Robertson.

Governor Shepardson likewise indicated that he thought the changes in wording were desirable. He was not entirely sure, however, that the Board had necessarily passed the point of commenting on the question whether banks should be permitted to engage in the equivalent of the mutual fund business. He believed that Governor Mills had raised a significant point.

Chairman Martin commented that while the practice might be questionable, banks were already so engaged. Now that the Comptroller of
the Currency had authority in this area, it might give the wrong impression if the Board were to comment on the practice at this late date.

In the course of further discussion, Governor Mills raised a question regarding the applicability of the tax relief provided by section 584 of the Internal Revenue Code to managing agency accounts as described in Regulation 9 of the Comptroller of the Currency. Mr. Nexter responded in detail, indicating that the Internal Revenue Service had issued a ruling to the effect that managing agency funds received by banks in trust would be accorded the tax relief provided by that section.

Governor Daane stated that, unless estopped at this point from expressing a view, he would like to see the Board go on record as being opposed to any subterfuge by which banks could get into the type of activity covered by the bills. In his judgment the Board had a responsibility to point out the dangers involved.

In discussion of this point, Governor Robertson recalled that before the regulation of common trust funds had been transferred to the Office of the Comptroller of the Currency the question whether banks should be permitted to engage in activities of the type covered by the proposed bills had been considered by the Board at length, but no definite decision had been reached. If the Board were now disposed to raise a
question on this subject, further study would be required. As he had indicated earlier, in his view the only point on which the Board should report at this time was whether the funds covered by the bills should be regulated by the Securities and Exchange Commission.

In further discussion a number of changes in the wording of the letter were suggested along the line of indicating that the Board was not at this time commenting on the wisdom of enlarging the scope of common trust funds to serve certain investment purposes.

Governor Balderston said he shared some of the qualms that had been expressed by Governor Mills and Governor Daane. He believed, however, that a clue to the situation the Board might take appeared in a paragraph of the Legal Division's memorandum which pointed out that bank supervision was concerned principally with the soundness and serviceability of banking institutions. On the contrary, the requirements of the securities legislation were directed toward the protection of investors in securities, by whomever issued. It was his view that when banks moved from the area of funds received for "bona fide" banking purposes into the area where funds were received and solicited for investment purposes, a matter of investor protection was concerned, and this was a problem for the Securities and Exchange Commission.

Governor Balderston also questioned the need for submitting a detailed statement commenting on specific provisions of the bill for use by the Committees in the event that they should report favorably on the bills.
Mr. Hexter commented that on occasion the Board submitted supplementary statements to Congressional Committees containing technical suggestions for changing proposed legislation. In this case, if the Board preferred, the suggestions could be made informally to staff members of the Congressional Committees.

At the conclusion of the discussion, it was understood that the draft letter to the Congressional Committees would be revised in light of the comments made at today's meeting prior to further consideration of the subject by the Board.

During the foregoing discussion Messrs. Noyes, Adviser to the Board, and Brill, Director, Division of Research and Statistics, entered the room and at its conclusion Mr. Sanders withdrew from the meeting.

Request of Chairman Patman for certain data (Items 1 and 2).

There had been distributed a memorandum from the Division of Data Processing dated March 13, 1964, regarding a request from Chairman Patman of the House Banking and Currency Committee for certain data from reports of condition for use in a study entitled "The Impact of Financial Institutions on Competition in Banking" that was being made for the Committee by Professors Polakoff and Sawhill. Chairman Patman's request had been received in a letter dated November 7, 1963, which Chairman Martin acknowledged on November 15 with an indication that the matter was being referred to the staff for further study to determine the magnitude of work involved in making the compilations requested, the priority that
could be assigned to the project, and the question whether the desired
data could be compiled without violating usual disclosure restrictions.
Since that time the Board's staff had conferred on several occasions
with the staff of the Committee and with Professor Sawhill regarding
the request.

After discussing the problem, the Division of Data Processing
recommended that the Board's computer and an operator be made available
for up to 50 hours to Professor Sawhill on weekends, as time permitted,
with individual bank data kept entirely under Board control. The arrange-
ment contemplated that Professor Sawhill would be required to develop
the necessary programs and furnish administrative assistance needed for
Processing the data. The recommendation was made on the basis of ascer-
taining first whether the Comptroller of the Currency and the Federal
Deposit Insurance Corporation would be agreeable to the Board's furnishing
data reported by national banks and insured nonmember banks before respond-
ing to Chairman Patman. In line with the recommendation, there was attached
to the memorandum a draft of letter that might be sent to the Comptroller
of the Currency and the Federal Deposit Insurance Corporation, along
with a draft of letter to Chairman Patman.

Following remarks by Mr. Langham, Governor Mills indicated that
he had some doubt as to the Board's ability to continue to comply with
requests such as this that involved so much allocation of time and effort.
He wondered if it might not be appropriate to point out that the Board's
facilities were necessarily limited.
Governor Daane suggested that from the standpoint of maintaining confidentiality of data it would be better if the computer work were performed at the Board rather than at an outside location.

Mr. Brill pointed out that in the area of economic analysis there was a need on the part of the Board's staff for working out techniques to avoid disclosure of confidential banking data. In this particular instance the Board was in the position of having to prepare the compilations requested by the Committee in order to preserve the confidentiality of the data furnished by individual banks.

In the course of the discussion that followed, Governor Balderston inquired whether the study being made by the Committee might be expected to reveal results that would be helpful to the Board. Mr. Brill responded that the project seemed to have some promise.

In response to a question that had been raised, Mr. Langham estimated that the out-of-pocket cost to the Board might be about $1,000.

Chairman Martin then expressed agreement with the recommendation of the Division of Data Processing and suggested that the proposed letter to the Comptroller of the Currency and the Federal Deposit Insurance Corporation be sent at this time, with the understanding that if the two agencies raised questions the matter would be considered further by the Board.

As drafted, the letter to the Comptroller of the Currency and the Federal Deposit Insurance Corporation would have as enclosures copies
of the Division of Data Processing's memorandum of March 13, correspondence
with Professor Sawhill, and the Board's contemplated reply to Chairman
Patman. Governor Daane suggested that the memorandum and the proposed
response to Chairman Patman need not be enclosed, and that the letters
to the two supervisory agencies could be expanded to whatever extent
seemed appropriate.

There was general agreement with Governor Daane's suggestion.
Accordingly, unanimous approval was given to letters to the Comptroller
of the Currency and the Federal Deposit Insurance Corporation in the
form attached as Items 1 and 2. It was understood that if the two agencies
interposed no objection to the Board's furnishing the requested information
for national banks and insured nonmember banks, the proposed letter to
Chairman Patman would be sent.

Messrs. Brill, Conkling, Bass, and Langham then withdrew from
the meeting.

Report on H. R. 9548 (Item No. 3). Pursuant to the understanding
at the meeting of the Board on March 13, 1964, a revised draft had been
distributed of a letter to Chairman Muter of the Subcommittee on Bank
Supervision and Insurance of the House Committee on Banking and Currency
reporting on H. R. 9548, a bill "To prohibit banks from performing certain
nonbanking services, and for other purposes." The bill would prohibit
every national bank, State member bank, and other insured bank from
performing any clerical, administrative, bookkeeping, statistical, accounting,
or other similar services for its depositors, borrowers, or other cus-
tomers, except to the extent that such services were a necessary incident
to the proper discharge of lawful functions of such banks as a depository,
lender, trustee, or agent. As drafted, the letter would indicate that
the Board was unfavorable to enactment of the bill.

Governor Robertson suggested that the letter be changed to
indicate that, while the Board would not favor enactment of the bill,
it did share the misgivings that had been expressed concerning the
tendency of some banks with modern data processing and other automated
equipment to use it for the performance of services essentially unrelated
to banking. The letter that he had in mind would state that, in order
to utilize its equipment economically, a bank should not be prohibited
some latitude in selling computer services, time, and capacity in excess
of its own needs. However, the Board believed that, as nearly as practi-
cable, a bank's computer installation should be used principally for the
performance of normal banking functions, either for itself or for other
banks, and that the size or capacity of the installation should be limited
accordingly.

Governor Daane noted the changes might give the impression that
the Board was taking a general position in principle against the selling
of excess computer time by banks. He recalled that Governor Mitchell
had considered such a procedure as a natural development for banks as
they acquired computer equipment. However, Governor Daane indicated
that he would not object to some rephrasing of the proposed letter along the lines suggested by Governor Robertson.

During the discussion that followed, in the course of which the language proposed by Governor Robertson was distributed for review, Governor Balderston raised a question as to whether it might not be informative for the Board to invite Mr. Raymond C. Kolb, formerly a member of the Board's staff and now employed by Mellon National Bank and Trust Company in Pittsburgh, Pennsylvania, to meet with the Board at some convenient time for a discussion of developments relating to computer usage by banks. There was general agreement with this suggestion.

At the conclusion of the discussion, approval was given to a letter to Chairman Multer in the form attached as Item No. 3.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following items:

Letter to the Federal Reserve Bank of New York (attached Item No. 4) approving the designation of five employees as special assistant examiners.

Memorandum from the Division of Examinations recommending acceptance of the resignation of Joseph E. Dougherty, Assistant Federal Reserve Examiner in that Division, effective at the close of business March 20, 1964.
March 25, 1964

The Honorable James J. Saxon,
Comptroller of the Currency,
Washington, D.C. 20220

Dear Mr. Saxon:

The Honorable Wright Patman, Chairman, Committee on Banking and Currency, has requested the Board to make numerous computations of data from reports of individual banks for use by Professors Polakoff and Sawhill in a study they are making for the Committee.

The proposed study, explained in some detail in the attached letter from Professor Sawhill, is entitled "The Impact of Financial Institutions on Competition in Banking." To complete the study as presently proposed will require the use of practically all of the items from the reverse of reports of condition of all insured commercial banks as of December 1960 and December 1962 as well as many of the items from the face of related earnings reports for the calendar years 1960 and 1962. A list of these items is included in the attachment.

It is estimated that to comply with this request would require 50 hours computer time, two months' full time of a competent programmer, and a large amount of clerical assistance. Since the Board's staff is fully occupied by prior assignments and commitments, it would not be able to initiate work on the proposed study in the near future. As an alternative, if agreeable to the other Federal Supervisory Agencies, the Board proposes to respond to Chairman Patman by making its computer and an operator, along with the necessary data, available for up to 50 hours to Professor Sawhill on weekends, as time permits, with individual bank data kept entirely under Board control and summarized so as to prevent individual bank disclosure. Professor Sawhill would develop the necessary programs and furnish administrative assistance needed for processing these data.
The Honorable James J. Saxon

The Board will appreciate your advising it whether your Office is agreeable to the Board furnishing condition and earnings data reported by national banks for use in the study requested by Chairman Patman, as described in greater detail in Professor Sawhill's letter of December 20, and in accordance with the procedure outlined above.

A similar letter is being addressed to Mr. Barr, Federal Deposit Insurance Corporation.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure
The Honorable Joseph W. Barr,
Chairman,
Federal Deposit Insurance Corporation,
Washington, D. C. 20429

Dear Mr. Barr:

The Honorable Wright Patman, Chairman, Committee on Banking and Currency, has requested the Board to make numerous computations of data from reports of individual banks for use by Professors Polakoff and Sawhill in a study they are making for the Committee.

The proposed study, explained in some detail in the attached letter from Professor Sawhill, is entitled "The Impact of Financial Institutions on Competition in Banking." To complete the study as presently proposed will require the use of practically all of the items from the reverse of reports of condition of all insured commercial banks as of December 1960 and December 1962 as well as many of the items from the face of related earnings reports for the calendar years 1960 and 1962. A list of these items is included in the attachment.

It is estimated that to comply with this request would require 50 hours computer time, two months' full time of a competent programmer, and a large amount of clerical assistance. Since the Board's staff is fully occupied by prior assignments and commitments, it would not be able to initiate work on the proposed study in the near future. As an alternative, if agreeable to the other Federal Supervisory Agencies, the Board proposes to respond to Chairman Patman by making its computer and an operator, along with the necessary data, available for up to 50 hours to Professor Sawhill on weekends, as time permits, with individual bank data kept entirely under Board control and summarized so as to prevent individual bank disclosure. Professor Sawhill would develop the necessary programs and furnish administrative assistance needed for processing these data.
The Board will appreciate your advising it whether your Office is agreeable to the Board furnishing condition and earnings data reported by insured nonmember banks for use in the study requested by Chairman Patman, as described in greater detail in Professor Sawhill's letter of December 20, and in accordance with the procedure outlined above.

A similar letter is being addressed to Mr. Saxon, Comptroller of the Currency.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure
The Honorable Abraham J. Multer, Chairman, Subcommittee on Bank Supervision and Insurance, Committee on Banking and Currency, House of Representatives, Washington, D. C. 20515.

My dear Mr. Chairman:

This is in response to your request for a report from the Board of Governors on H. R. 9548, a bill "To prohibit banks from performing certain nonbanking services, and for other purposes."

The bill would prohibit every national bank, State member bank, and other insured bank from performing "any clerical, administrative, bookkeeping, statistical, accounting, or other similar services for its depositors, borrowers, or other customers, except to the extent that such services are a necessary incident to the proper discharge of lawful functions of such banks as a depository, lender, trustee, or agent."

The Board would not favor enactment of H. R. 9548. The Board does, however, share the misgivings that have been expressed concerning the tendency of some banks with modern data processing and other automated equipment to use it for the performance of services essentially unrelated to banking.

The problem arises in large part from the relatively high cost of such equipment and its adaptability to the performance of a wide range of data processing and related services. In order to utilize its equipment economically, a bank should not be prohibited some latitude in selling computer services, time, and capacity in excess of its own needs. Occasions for this may arise especially at the outset of a bank's computer operation and before some of the banking functions susceptible thereto have been automated. At the same time, the Board believes that, as nearly as practicable, a bank's computer installation should be used principally for the performance of normal banking functions, either for itself or for other banks, and that the size or capacity of the installation should be limited accordingly. Normal banking services should be regarded as excluding services for nonbank customers unless there exists a specific tie-in between the particular service and a banking transaction for the customer involved.
Voluntary adherence to the principles outlined above would adequately keep banks in the banking business, and we believe your hearings will help in minimizing the problems that have arisen as banks seek to find their proper role in furnishing data processing services. As indicated previously, the Board does not think that the situation warrants so severe a step as the adoption of the prohibition in H. R. 9548.

Public Law 87-856, approved October 23, 1962, permits banks to pool their efforts by joining in the ownership of data processing organizations. Section 4 of that Act forbids such a cooperative service corporation to "engage in any activity other than the performance of bank services for banks." If a single bank owning data processing equipment is permitted to use its excess capacity for other than its own needs, these cooperative service corporations should likewise be authorized to do so and hence section 4 should be repealed.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.
Mr. Howard D. Crosse, Vice President,
Federal Reserve Bank of New York,
New York, New York 10045.

Dear Mr. Crosse:

In accordance with the request contained in your letter of March 10, 1964, the Board approves the designation of the following employees as special assistant examiners for the Federal Reserve Bank of New York for the purpose of participating in examinations of State member banks:

Angelo M. Baldassare
Robert E. Lisk
Frederick R. Miller
Daniel F. Sheehy, Jr.
Leo Smith

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.