

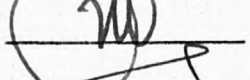
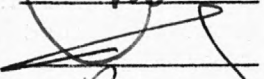
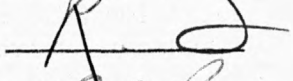

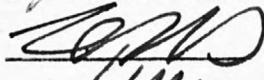
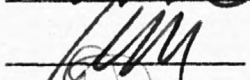
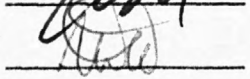
Minutes for April 6, 1964

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	<u></u>
Gov. Mills	<u></u>
Gov. Robertson	<u></u>
Gov. Balderston	<u></u>
Gov. Shepardson	<u></u>
Gov. Mitchell	<u></u>
Gov. Daane	<u></u>

Minutes of the Board of Governors of the Federal Reserve System on Monday, April 6, 1964. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Mitchell
Mr. Daane

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Young, Adviser to the Board and Director,
Division of International Finance
Mr. Noyes, Adviser to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research
and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Connell, Controller
Mr. Schwartz, Director, Division of Data
Processing
Mr. O'Connell, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Sammons, Adviser, Division of International
Finance
Mr. Thompson, Assistant Director, Division
of Examinations
Mr. Spencer, General Assistant, Office of
the Secretary
Mr. Potter, Senior Attorney, Legal Division
Mr. McClintock, Supervisory Review Examiner,
Division of Examinations
Mr. Guth, Review Examiner, Division of
Examinations

Alaskan banking situation. Mr. Solomon, who had attended a recent meeting at the Treasury Department concerned with the condition of banking services in Alaska as a result of the recent earthquake, reported on that meeting as well as the findings of System representatives who had gone to Alaska to study the banking situation. The banks

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were reported open and operating, and it appeared that the picture was quite satisfactory. Assistance to the banks had not been requested of the Federal Reserve up to the present time. However, representatives of the Comptroller of the Currency had indicated that some banks might request relief from reserve requirements.

At the conclusion of Mr. Solomon's report, there was a brief discussion, the sense of which was that the Board questioned whether it would be appropriate to consider granting relief through a relaxation of reserve requirements, if a request of that kind were made.

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

	<u>Item No.</u>
Letter to the Federal Deposit Insurance Corporation regarding the application of Englewood State Bank, Englewood, Colorado, for continuation of deposit insurance after withdrawal from membership in the Federal Reserve System.	1
Letter to Chairman Robertson of the Senate Banking and Currency Committee reporting on S. 2506, a bill "To extend the Defense Production Act of 1950, and for other purposes."	2
Letter to Tennessee Gas Transmission Company, Houston, Texas, and Tenneco Corporation, Houston, Texas, granting determinations exempting them from all holding company affiliate requirements except those contained in section 23A of the Federal Reserve Act.	3

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	<u>Item No.</u>
Letter to the Federal Reserve Bank of San Francisco with regard to the application of section 6(a) of the Bank Holding Company Act to certain situations involving transactions between holding company banks.	4
Interpretation on the application of section 6(a) of the Bank Holding Company Act to certain situations involving transactions between holding company banks.	5

Governor Robertson abstained from voting on Item No. 3. Governor Mills stated that he would not vote to deny the requested determinations because the case appeared to fall within the scope of the Board's policy applicable to so-called one-bank cases. However, this was another illustration, in the holding company field, of buying and bartering of bank shares for purposes not related to the sound conduct of banking functions. Governor Shepardson concurred.

With respect to Items 4 and 5, Mr. Potter reviewed the transactions involved and the application thereto of provisions of section 6(a) of the Bank Holding Company Act. In the course of his remarks, he referred to suggestions by the staff for minor changes in the wording of the interpretation as distributed. In discussion, Governor Mills raised several questions related to the three situations in question, to which Mr. Potter responded with explanatory comments. The draft of letter to the San Francisco Reserve Bank, and the proposed interpretation-- in a form reflecting the suggested changes in language agreed upon during the discussion--were then approved, Governor Mitchell abstaining from

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voting. It was understood that the interpretation would be published in the Federal Register and the Federal Reserve Bulletin.

Procedure for handling technical questions. With respect to the aforementioned Items 4 and 5, Governor Daane raised the question whether something could be done by way of delegation of authority or otherwise to avoid the necessity for the Board to consider in detail matters that involved technical legal questions. He suggested that such matters, at the least, could be included on the agenda in a manner conducive to their being handled expeditiously unless members of the Board had specific questions about them.

Mr. Hackley commented that for as long as he could remember, even the most technical legal questions had been presented to the Board for approval before any letter was sent or ruling based thereon was published. If it so wished, the Board as a legal matter could delegate to the Legal Division the handling of responses to inquiries on legal questions, subject to the right of appeal for an official Board position by the party making inquiry.

Governor Mills indicated that he felt items like the one on the agenda today were of importance because they often touched on policy questions. Such matters could be time consuming, but he did not see how the Legal Division could feel capable of making decisions that involved policy determination.

Mr. Hackley stated that he agreed with Governor Mills. He would be unhappy if the Legal Division were delegated responsibility for preparing

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and issuing rulings, particularly of the type that involved significant questions of policy.

There followed further discussion during which Governor Mitchell indicated that he agreed essentially with what Governor Daane had said. He inquired whether, in cases of the kind under discussion, the Legal Division could do more to separate policy considerations from legal reasoning in presenting the cases to the Board.

Mr. Hackley replied to the effect that it was difficult to distinguish clearly between matters of policy and matters of law in these matters, and Mr. O'Connell added that in some instances the questions involved statutory provisions for which criminal penalties were specified in event of violation.

Governor Daane concluded the discussion by saying that the Board should clearly stand behind any interpretations and take the responsibility for them. However, when complex technical matters were under consideration, he did not profess to be as well qualified as the Legal Division in sorting out the legal issues.

Accuracy of Government economic statistics. There had been distributed a memorandum dated April 1, 1964, from Messrs. Young, Adviser to the Board and Director, Division of International Finance, and Brill, Director, Division of Research and Statistics, with regard to an article by Professor Oskar Morgenstern of Princeton University in the October 1963 issue of Fortune Magazine that raised certain questions about the accuracy of basic economic data compiled and published by Government agencies.

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Representative Curtis of the Joint Economic Committee had asked Mr. Raymond Bowman, Assistant Director for Statistical Standards of the Bureau of the Budget, to comment on the article's thesis, and he had also suggested that the issue of data accuracy might be the subject of hearings next year before the Subcommittee on Economic Statistics.

In this connection, Mr. Bowman wished to determine the Board's willingness to sponsor an inquiry into the broad subject of the accuracy of economic statistics. No detailed plans had yet been developed, but the general thinking was along the lines of organizing a committee of distinguished scholars and experts who, in turn, would appoint task forces to review specific types of data collection techniques and recommend improvements in procedures or develop some techniques for assessing quantitatively the degree of error in published data.

Copies of Professor Morgenstern's article and Mr. Bowman's detailed reply to Congressman Curtis were attached to the memorandum.

At the Board's request, Mr. Young commented in supplementation of the information presented in the memorandum. He noted, among other things, that Mr. Bowman had expressed the view that it would be desirable to have an inquiry into the accuracy of economic statistics made under the auspices of the Federal Reserve, rather than the Bureau of the Budget, to avoid any charge of "whitewash." Mr. Young went on to comment that while there was much to be said in favor of a project of this kind, he felt it was debatable whether the Federal Reserve should sponsor it. The

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proposal, as made, contemplated that a committee of outside academic people would be set up and given a free hand to get the study under way and appoint subcommittees. Experience had shown, however, that in order to make such work effective, the Board had to supply technical staff. As an alternative possibility, the study might be turned over to an organization such as the National Bureau for Economic Research, with the Board providing the financing.

Mr. Brill commented that there were of course certain advantages in undertaking a project of this nature. Such a study could be valuable in terms of informing the public that the statistical data were not perfect and that it was difficult to eliminate some types of errors. On the other hand, such a project could be costly in terms of staff resources. Whether the Board sponsored the study or conducted it, there would be some drain on staff time. If the study were farmed out to another organization, there might be less senior staff time involved but there would no doubt be considerable time required at the technical staff level in any event.

Mr. Noyes said that he had a negative reaction toward the proposal. He would like to see the Board encourage the Budget Bureau to sponsor further inquiries into matters such as employment and balance of payments data. Such studies could make a valuable contribution. However, in his view the study being proposed was not really directed toward the improvement of statistics. Instead, it involved an effort to educate the public on the limitations of economic statistics, most

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of which were unavoidable. Therefore, it did not seem to him to be something that should receive high priority in light of the Board's other statistical programs. He would not like to see those programs deferred.

Mr. Young commented that, on the other hand, a committee studying the accuracy of economic statistics might come up with some desirable recommendations for the improvement of existing statistical series. If such a study could be largely delegated to an outside group, it might be worthwhile undertaking. He had some sympathy toward the proposed study, although he also saw Mr. Noyes' point of view.

As the discussion proceeded, the members of the Board expressed views along the lines indicated in the following paragraphs.

Governor Mitchell stated that if the study were for the purpose of educating the general public (non-professionals) about the limitations of economic data, he foresaw that little would be accomplished. If, on the other hand, there was an assumption that something was going to be learned about the quality of the statistics, this could be erroneous; the people putting out the statistical data already knew a great deal about the limitations and shortcomings. On balance, he came out feeling that this probably was not the type of project that the Board should undertake. It was somewhat different from the studies made for the Talle Subcommittee in 1955. In that instance, there were several specific fields where an effort was made to try to improve the quality of data by making specific recommendations for changes, and the proposed inquiry

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did not appear to be comparable. Further, he was opposed to diverting staff resources to this study because the Board had other projects that he considered more vital, and it would mean slipping behind on those if the project was undertaken. In summary, he was not in favor of active Board participation in a study of the kind proposed. He might be willing to have the Board contribute a modest amount of money toward a study that held promise of useful results, did not involve use of the Board's staff, and did not smack of back-door financing, but those might be impossible conditions.

Governor Daane expressed the view that if the study were designed to provide merely a public relations defense, the Board should not take part in it, financially or otherwise. If it were a constructive effort to improve statistical data and held promise of fruitfulness in that direction, he would feel differently. If the Board were to sponsor a study such as proposed, he believed that inevitably this would mean involvement on the part of the Board's staff. At the same time, he was dubious about turning such a study over to an organization such as the National Bureau for Economic Research because this would mean putting the stamp of Federal Reserve sponsorship on it. In summary, he did not feel that the Board should sponsor or lead the project. However, if the Budget Bureau were to come forward with a worthwhile program looking toward the improvement of Government economic statistics, he felt that the Board could justify some contribution of funds, but not staff.

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Governor Mills expressed the opinion that the Board should not engage in a study such as proposed. For one thing, he did not like the back-door financing aspect of it. Also, he had not heard of concrete reforms resulting from the substantial effort expended on improvement of certain statistical data several years ago. If there were serious shortcomings in the Government statistical program and reforms had not been accomplished, he felt that the Budget Bureau must accept a share of the blame.

Governor Robertson said that generally speaking he favored any research of a constructive nature that could be afforded. However, he was impressed by the comments at this meeting, which indicated that the sponsorship of a project such as suggested by the Budget Bureau would inevitably involve a drain of staff resources away from other important programs. Therefore, he would put it off.

Governor Shepardson indicated that he questioned what would be accomplished of a constructive nature by participating in the proposed study.

Governor Balderston said it was his general feeling that if the National Bureau for Economic Research could obtain support from other sources, for example, foundation support, for this study, it might be defensible for the Board to make a contribution toward the total cost because of the Board's involvement in the Federal statistical program. However, he was in agreement with the view that the Board should not

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sponsor or lead the study and that any contribution should be limited to funds rather than staff.

It was therefore the consensus that Mr. Bowman should be informed that the Board would not feel disposed to sponsor the kind of project currently being proposed, although it might be willing to contribute to a modest extent to some alternative program, if one were formulated by the Bureau of the Budget, that held promise of constructive results in improving the quality of Federal economic statistics.

Messrs. Noyes, Brill, Connell, and Schwartz then withdrew from the meeting.

Vietnam examiner training program. There had been distributed a memorandum dated April 2, 1964, from the Division of Examinations discussing a Department of State request for three Federal Reserve bank examiners to go to Saigon, Vietnam, for approximately four months for the purpose of conducting one or two examinations with the assistance of examiners from Vietnam, giving advice on banking legislation, and helping to set up a training program for additional Vietnamese examiners. It was understood that the Federal Reserve would be reimbursed by the Agency for International Development for expenses incurred.

In discussion, the Board expressed a willingness to cooperate with the request of the Department of State, and agreement was indicated with a suggestion by Governor Robertson that the Division of Examinations communicate with the Federal Reserve Banks for the purpose of ascertaining what personnel would be available for the assignment.

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Secretary's Note: The State Department subsequently advised that it was obtaining the requested personnel from another source.

The meeting then adjourned.

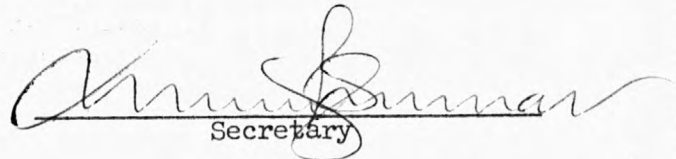
Secretary's Notes: Governor Shepardson advised the Secretary that after consultation with other members of the Board, he had authorized payment of the cost of a dinner on April 30, 1964, for the group of academic economists who were to meet with the Board on May 1, 1964.

Governor Shepardson today approved on behalf of the Board the following items:

Letter to the Federal Reserve Bank of Boston (attached Item No. 6) approving the designation of 32 employees as special assistant examiners.

Memorandum dated April 3, 1964, from Mr. Morgan, Staff Assistant, Board Members' Offices, recommending that three prints of the System film, "Money on the Move," be furnished to the U. S. Information Agency, at a cost to the Board of \$380.

Memorandum dated April 3, 1964, from Mr. Noyes, Adviser to the Board, requesting authority to arrange for about 10 days of the time of Professor William Davenport of Harvey Mudd College, Claremont, California, at the rate of \$50 per day, on either a contractual or consultant basis, for rewriting of the initial draft of a pamphlet presenting a simplified explanation of the Federal Reserve System.


Secretary

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Item No. 1

4/6/64

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 6, 1964



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

Dear Mr. Barr:

Reference is made to your letter of March 23, 1964, concerning the application of Englewood State Bank, Englewood, Colorado, for continuance of deposit insurance after withdrawal from membership in the Federal Reserve System.

While there are no corrective programs that the Board of Governors believes should be incorporated as conditions to the continuance of deposit insurance, the bank has been urged to strengthen its capital position.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
4/6/64

OFFICE OF THE CHAIRMAN

April 7, 1964



The Honorable A. Willis Robertson,
Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to your request of March 24, 1964, for the Board's views with respect to the bill, S. 2506, "To extend the Defense Production Act of 1950, and for other purposes."

Section 1 of the bill would extend until June 30, 1966, the authorities contained in the Act. The only provisions of the Act which directly concern the responsibilities of the Board are contained in Title III relating to Government guaranteed loans for defense production under the Board's Regulation V, and since the Office of Emergency Planning considers that this authority is useful, particularly to the procuring agencies as means of assisting their contractors in securing working capital and additional equipment needed for the performance of defense contracts, the Board would have no objection to the extension of this program for an additional two years as provided by the bill.

The Board has no comment with respect to other provisions of the bill which are concerned with matters not directly related to the Board's primary responsibilities.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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

Item No. 3
4/6/64



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 6, 1964.

Mr. R. E. McGee, Senior Vice President,
Tennessee Gas Transmission Company,
P. O. Box 2511,
Tennessee Building,
Houston, Texas.

Mr. L. R. Spence, Secretary,
Tenneco Corporation,
P. O. Box 2511,
Houston, Texas.

Gentlemen:

This refers to the requests contained in the letters dated February 5, 1964, submitted through the Federal Reserve Bank of Dallas, for determinations by the Board of Governors of the Federal Reserve System as to the future status of Tennessee Gas Transmission Company and Tenneco Corporation as holding company affiliates.

From information presented, the Board understands that Tennessee Gas Transmission Company and two of its subsidiaries are engaged directly in the ownership and operation of natural gas pipe line systems for the transmission and sale or delivery of natural gas; that Tennessee Gas Transmission Company owns all of the outstanding common stock, representing 75 per cent of the total voting power, of Tenneco Corporation, and Tenneco Corporation owns 75 per cent of the outstanding shares of Tennessee Life Insurance Company, Houston, Texas; that Tenneco Corporation is the parent company of numerous subsidiaries, most of which are wholly owned, which are engaged in a variety of non-utility activities, including the production, refining, and marketing of petroleum products, and from time to time it also invests in stocks of other corporations as an investor rather than as an indirect participant in the businesses which they carry on; that Tennessee Life Insurance Company is engaged directly in the business of writing life, accident, and health insurance on an ordinary and

Mr. R. E. McGee and
Mr. L. R. Spence

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group basis; that Tennessee Gas Transmission Company and Tenneco Corporation would be holding company affiliates of Tennessee Bank and Trust Company, Houston, Texas, if that bank became a member of the Federal Reserve System because they own or control, directly or indirectly, more than 50 per cent of the shares of Tennessee Bank and Trust Company voted for the election of directors of that bank at the preceding election; that Tennessee Gas Transmission Company and Tenneco Corporation own or control, directly or indirectly, only 20 per cent of the outstanding shares of Citizens State Bank, Houston, Texas; that except for the aforementioned bank shares, other investments in bank stock or stock of bank holding companies by Tennessee Gas Transmission Company and its subsidiaries include no single investment of as much as two-tenths of one per cent of the outstanding shares of any bank or bank holding company; and that in the aggregate, the value of investments in shares of banks and bank holding companies amounts to less than 3 per cent of the total assets of Tenneco Corporation and a much lesser percentage of the total assets of Tennessee Gas Transmission Company.

In view of these facts, the Board has determined that Tennessee Gas Transmission Company and Tenneco Corporation, upon admission of Tennessee Bank and Trust Company to membership in the Federal Reserve System, will not be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks or trust companies within the meaning of section 2(c) of the Banking Act of 1933 (12 U.S.C. 221a); and, accordingly, will not be deemed to be holding company affiliates except for the purposes of Section 23A of the Federal Reserve Act and will not need voting permits from the Board of Governors in order to vote the bank stock which they own or control.

If, however, the facts should at any time indicate that Tennessee Gas Transmission Company and Tenneco Corporation might be deemed to be so engaged, this matter should again be submitted to the Board. The Board reserves the right to rescind these determinations and make further determinations of this matter at any time on the basis of the then existing facts, including additional acquisitions of bank stocks even though not constituting control.

Very truly yours,

Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 4
4/6/64



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 8, 1964

Mr. Walter Scott, General Counsel,
Federal Reserve Bank of San Francisco,
San Francisco, California. 94120

Dear Mr. Scott:

This refers to letters dated January 17 and 22, 1964, from Mr. Cooper to Mr. O'Connell, and related telephone conversations, concerning the application of section 6(a)(4) of the Bank Holding Company Act to three situations involving transactions between holding company banks. The first situation involves interest-bearing deposits between The Bank of Tokyo, Ltd., a registered bank holding company, and The Bank of Tokyo of California, a subsidiary nonmember insured bank - the question being whether these are prohibited "loans". The other two situations involve, in substance, loan "transfers" between subsidiary banks of Western Bancorporation, the general question in each case being whether the transfer amounts to the making of a "new loan" rather than a "discount" prohibited by section 6(a)(4).

While the principles involved are fairly well-settled by the Board, the question of their application to the specific fact situations presented was considered to warrant the submission of your questions to the Board, and the Board has decided to issue a published interpretation based on its determinations. Accordingly, you are requested to advise your correspondents of the substance of the Board's responses to their respective questions, as set forth below, and that these responses will be the subject of a published interpretation without identification of the parties involved. For the purposes of anonymity, the proposed interpretation treats the interest-bearing deposits question without reference to the foreign bank holding company element. For your information, there is enclosed a copy of the interpretation in the form in which it will be submitted for publication.

Question 1. - Interest-bearing deposits between holding company banks as "loans" or "extensions of credit" under section 6(a)(4) of the Bank Holding Company Act. (Telephone call from Mr. Cooper to Mr. O'Connell, January 10, 1964)

The Bank of Tokyo, Ltd., a Japanese bank which is also a registered bank holding company, has an interest-bearing deposit with its California subsidiary The Bank of Tokyo of California, a nonmember

Mr. Walter Scott

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insured bank. The latter bank, at last report, was planning to deposit a sum of money at interest with the London branch of its parent, The Bank of Tokyo, Ltd.

Section 6 of the Act provides in part as follows:

"(a) From and after the date of enactment of this Act, it shall be unlawful for a bank--

* * *

"(4) to make any loan, discount or extension of credit to a bank holding company of which it is a subsidiary or to any other subsidiary of such bank holding company.

* * *

"Non-interest-bearing deposits to the credit of a bank shall not be deemed to be a loan or advance to the bank of deposit. . . ."

The converse of the last-quoted provision of section 6(a) is that an interest-bearing deposit shall be regarded as a loan or extension of credit for the purposes of the prohibitions of that section. The Board so interprets the statutory language, and sees nothing in the facts of this case that would warrant a different view.

Thus, the Board finds that the above-described interest-bearing deposit of the California bank with the London branch of The Bank of Tokyo, Ltd., would be prohibited by section 6(a)(4) as loan or extension of credit by a "bank" to a bank holding company of which it is a subsidiary. It may be noted that the foreign situs of a bank holding company does not affect the application of the penalty provisions of section 8 of the Act to willful violations by a subsidiary bank having a domestic situs.

The Board concludes, however, that the deposit of The Bank of Tokyo, Ltd., with the California bank is not so prohibited because (1) the lender, a foreign bank, is not a "bank" as defined in section 2(c) of the Act, and (2) even if it were a "bank", the prohibition apparently does not apply, by its own terms and by the language of section 222.6 of the Board's Regulation Y, to a bank which is not a co-subsiary, with its borrower, of a bank holding company.

Question 2. - Inter-subsiary mortgage loan transfer upon substitution of new borrower. (Mr. Cooper's letter of January 17, 1964)

According to the above letter, with enclosures, a home-loan borrower from the Bank of Nevada proposed to sell his home to a purchaser

Mr. Walter Scott

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who would assume liability on the note and mortgage. Subject to the receipt of favorable advice as to the application of section 6(a)(4), the Bank of Nevada proposed to "transfer" the loan to the First National Bank of Nevada, a co-subsidiary of Western Bancorporation, a registered bank holding company, contemporaneously with the substitution of borrowers. The letter of January 14, 1964, to you from the Executive Vice President of the Bank of Nevada states: "The First National Bank is willing to accept the new purchaser as the debtor and has told us that if we will forward our loan to them for collection they will record the substitution of liability, and in effect this actually would be a new credit transaction."

The question is raised whether such a loan transfer would be a sale of paper equivalent to a "discount" prohibited by section 6(a)(4), in accordance with the Board's decision in the Matter of General Contract Corporation, 44 F. R. Bulletin 260 (1958). In the course of that opinion and in the subsequent interpretation at 44 F. R. Bulletin 1059 (1958) (Published Interpretations, ¶7400), the Board took the position, in effect, that bank loans might be participated without involving a "discount" if the participations are "joined at the outset" so that they do not involve the sale of an asset by the "originating bank" to another bank. This position was further defined by the Board in an unpublished letter interpretation at F.R.L.S. #9402, p. 3271, where the Board considered what changes in the incidents of a loan - such as changes in borrower or collateral - would permit it to be treated as a "new loan" at the time of such changes so as to be then eligible for participation "at the outset". In that interpretation the Board stated:

"Where a new borrower is substituted in good faith, as in the case of the sale of a financed automobile by the original borrower thereon and the assumption of the loan by the purchaser, the loan may be treated as 'new' and therefore eligible for participation." (F.R.L.S., p. 3272-1)

Assuming the requisite good faith, the substitution of borrowers in the present case appears to correspond in principle with the situation just described. Further, as the Board stated in its letter of January 15, 1960, to your Bank, if the conditions that will permit a loan to be participated "at the outset" are met, in accordance with the interpretation at 44 F. R. Bulletin 1059 (1958), it is immaterial whether the "second bank (1) takes only a participation or (2) makes the entire loan."

Therefore, it appears to the Board that, if the substitution of borrowers in this case meets the tests of a "new loan" as indicated above, the loan might be "transferred" between the holding company subsidiaries, provided that the substitution of the First National Bank

Mr. Walter Scott

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of Nevada as lender is accomplished in a manner consistent with the 1958 interpretation cited above; "the outset" in this case would refer to the time of substitution of borrowers.

Question 3. - Substitution of borrowers by merger as making a loan eligible, as a "new loan", for transfer between co-subsidiary banks.

(Mr. Cooper's letter of January 22, 1964)

The facts may be summarized as follows:

B Corporation has a line of credit with Western Bancorporation subsidiary Y Bank. By the terms of a proposed merger of B Corporation into A Corporation, A Corporation is to assume B's loan liability. It is proposed that at the time of the merger, when A Corporation is substituted as borrower on B's old line of credit with Y Bank, Y's co-subsidiary X Bank be substituted as lender. X Bank would take a new note from A Corporation, pay off Y Bank, and take an assignment of collateral from Y Bank. Prior to the merger, B Corporation is wholly owned by A Corporation.

For the purposes of section 6(a)(4) of the Act, the principles involved in the above fact situation appear to be essentially the same as those discussed under Question 2, above. Therefore, it is the Board's judgment, with one important reservation to be noted, that the substitution of lenders as described would be permissible if accomplished "at the outset" with respect to the merger.

The reservation referred to above relates to the fact that in this case the original borrower - B Corporation - is, prior to the merger, a wholly-owned subsidiary of the new borrower - A Corporation. If the separate corporate identities are merely a matter of form and not substance so far as the original line of credit is concerned, then their relationship might preclude A Corporation from being regarded as a "new borrower" to the extent required for there to be a "new loan". In the Board's judgment, therefore, whether section 6(a)(4) permits the substitution of lenders in this case must depend finally on whether Y Bank had legal recourse against A Corporation, prior to the merger, for the satisfaction of B's note, upon B's default or otherwise. The fact of A's ownership of B Corporation would not by itself, of course, establish such liability on the part of A. However, if A had guaranteed B's note, or had provided security, or otherwise shared legal responsibility on the note, the merger of the two corporations would not represent a good faith substitution of borrowers for the purposes of section 6(a)(4).

Mr. Walter Scott

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The question of A Corporation's pre-merger liability will be treated in the forthcoming published interpretation without the necessity of a prior determination of the actual fact in the Western Bancorporation case. It is essential, however, that, in reporting the Board's views on this matter, it be made clear to the inquiring bank that, if A Corporation is not in substance a "new borrower" in accordance with the foregoing discussion, then the substitution of A Corporation by merger as borrower on B's line of credit with Y Bank would not make that line of credit a "new loan" eligible for a substitution of lenders as described. It will be appreciated if you will advise the Board of your findings and opinion with respect to this particular question, as well as with respect to the further disposition of the three general questions discussed herein.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure

TITLE 12 - BANKS AND BANKING

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Y]

PART 222--BANK HOLDING COMPANIES

§ 222.117 Loans, discounts, and extensions of credit: interest-bearing deposits, substitution of borrowers.

(a) The Board of Governors has recently been asked to consider the application of section 6(a) of the Bank Holding Company Act ("the Act") to three different factual situations involving transactions between holding company banks. All three questions pertain to the application of section 6(a)(4) of the Act, under which it is unlawful for a bank "to make any loan, discount or extension of credit to a bank holding company of which it is a subsidiary or to any other subsidiary of such bank holding company."

(b) Interest-bearing deposits as "loans" or "extensions of credit".-

(1) The first question involves (i) an interest-bearing deposit by a bank, which is also a registered bank holding company, with a subsidiary bank, and (ii) an interest-bearing deposit by the subsidiary bank with a branch of its parent bank, the bank holding company.

(2) The last paragraph of section 6(a) of the Act provides in part that "Non-interest-bearing deposits to the credit of a bank shall not be deemed to be a loan or advance to the bank of deposit. . . ." On the basis of the clear implication of that

language, it is the Board's position that an interest-bearing deposit shall be deemed to be a loan or advance unless the circumstances of a particular case strongly compel a different conclusion.

(3) Assuming that the interest-bearing deposits in the present case are to be deemed to be loans or advances, the deposit by the subsidiary bank with the branch of its parent holding company would be prohibited as a "loan" or "extension of credit" by a "bank", as defined in section 2(c) of the Act, "to a bank holding company of which it is a subsidiary". However, the deposit by the parent bank, the bank holding company, with its subsidiary bank would not be prohibited because, on the basis of the language of section 6(a)(4) of the Act and § 222.6 of this Part (Reg. Y), the prohibition does not apply to a loan by a bank which is not itself a subsidiary of a bank holding company.

(c) Inter-subsidiary mortgage loan transfer upon substitution of new borrower.

(1) The second question involves the "transfer" of a home mortgage loan from holding company bank "X" to co-subsidiary bank "Y" in connection with the substitution of the purchaser of the home for the seller as borrower. Bank X agrees to forward the loan to Bank Y for the recording of substitution of liability and for collection.

(2) The question is whether such a loan transfer is a sale of paper equivalent to a "discount" prohibited by section 6(a)(4) of the Act in accordance with the Board's decision in the matter of

General Contract Corporation, 44 F.R. Bulletin 260 (1958). In the course of that opinion, the Board took the position, in effect, that bank loans might be participated, without involving a "discount" of the amount of the participation, provided that the participations are "joined at the outset". A subsequent interpretation in 1958, codified as § 222.105, contains examples of the methods by which a loan might be participated "at the outset" so that it would not involve the sale of an asset of the "originating" bank. The Board has also taken the position that upon certain changes in the incidents of a loan it may be regarded as a "new loan" so that the participation of the loan as of the time of such a change becomes permissible as a participation "at the outset".

(3) The substitution of a new borrower in good faith, as in the case of the sale of a mortgaged home by the original borrower thereon and the assumption of the loan by the purchaser, is regarded by the Board as a change permitting the loan to be treated as a "new loan" eligible for participation as of the time of the substitution of borrowers. It is clear that the same principles that determine the eligibility of a loan for participation also determine eligibility for a change of lenders as to the entire amount of the loan.

(4) Therefore, it is the Board's position that the substitution of borrowers on the home mortgage loan as described would permit the loan to be transferred between holding company co-subsidiary banks, provided that the transfer is accomplished "at the outset" with respect to the substitution of borrowers, in a manner consistent with the 1958 interpretation cited above.

(d) Inter-subsidiary transfer of corporate loan upon a substitution of borrowers by merger.

(1) The facts pertaining to the third question may be summarized as follows: B Corporation has a line of credit with holding company subsidiary Y Bank. By the terms of a proposed merger of B Corporation into A Corporation, A Corporation is to assume B's loan liability. It is proposed that at the time of the merger, when A Corporation is substituted as borrower on B's old line of credit with Y Bank, Y's co-subsidiary X Bank be substituted as lender. X Bank would take a new note from A Corporation, pay off Y Bank, and take an assignment of collateral from Y Bank. Prior to the merger, B Corporation is wholly owned by A Corporation.

(2) If A Corporation's assumption of B Corporation's liability can be regarded as the good faith substitution of a new borrower, that event would permit the outstanding line of credit and advances thereunder to be regarded as a "new loan" eligible for transfer between co-subsidiary banks at the time of such substitution, on the same principles as those applied above in the case of the home loan mortgage. However, the fact that prior to the merger B Corporation is wholly owned by A Corporation raises the question whether A Corporation should be regarded as a "new borrower" for the purposes of section 6(a)(4) in this case.

(3) The Board takes the position that, if A Corporation has had no legal liability as to B Corporation's line of credit (or the security given therefore) prior to the merger, then A Corporation may

be regarded as a "new borrower" in spite of its stock ownership of B Corporation. However, a substitution of borrowers will not constitute the making of a new loan unless the "new borrower" is in fact entirely new so far as liability on the loan or extension of credit is concerned; when there is a corporate affiliation as in this case, it becomes particularly appropriate to make inquiry as to whether there is in fact a good faith substitution of borrowers.

(12 U.S.C. 1844)

Dated at Washington, D. C., this 6th day of April, 1964.

By order of the Board of Governors.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

4/6/64

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 6, 1964

Mr. Luther M. Hoyle, Jr., Vice President,
Federal Reserve Bank of Boston,
Boston, Massachusetts. 02106

Dear Mr. Hoyle:

In accordance with the request contained in your letter of April 1, 1964, the Board approves the designation of the following employees as special assistant examiners for the Federal Reserve Bank of Boston for the purpose of participating in examinations of State Street Bank and Trust Company, Boston, Massachusetts; The Connecticut Bank and Trust Company, Hartford, Connecticut; Depositors Trust Company, Augusta, Maine; The Merrill Trust Company, Bangor, Maine; and Rhode Island Hospital Trust Company, Providence, Rhode Island.

Bigwood, Joseph G.
Bubluski, Carol A.
Clark, Mildred A.
Cohen, Dorothea M.
Comoletti, Eleanor
Corlin, Marilyn L.
Cummings, Foster K.
Czarnetski, Mary L.
D'Ambrosio, Michelina
DiMaggio, Carol A.
Donahue, Frederick W.
Farrell, Arthur C.
Finney, Donald G.
Flaherty, Paul J.
Fucarile, Josephine
Giordano, Rita M.

Greeley, Regina S.
Greenfield, C. Laurence
Herman, Harris K.
Kinsman, David F.
Lovett, Joan P.
Macone, Dominic F.
McCarthy, Maura J.
McLaughlin, Paul M.
Montague, Claire A.
Olivolo, Rosemarie
Santospirito, Yolanda
Sullivan, Ethel M.
Talbot, Dixie Lee
Veitch, Susan A.
Walsh, Alma
Walsh, Marian E.

Appropriate notations have been made on our records of the names to be deleted from the list of special assistant examiners.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.