Minutes for April 7, 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 Tuesday, April 7, 1964. The Board met in the Board Room at 11:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Johnson, Director, Division of Personnel Administration
Mr. Sprecher, Assistant Director, Division of Personnel Administration
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Hart, Personnel Assistant, Division of Personnel Administration

Retirement System proposals (Item No. 1). There had been distributed a memorandum dated March 20, 1964, from the Division of Personnel Administration regarding recommendations relating to the Retirement System of the Federal Reserve Banks and related fringe benefits made by the Subcommittee on Personnel of the Conference of Presidents of the Federal Reserve Banks and approved by the Conference on January 28, 1964. The recommendations were as follows:

> (1) to establish a $1,000 post-retirement death benefit for all present and future service retirees who, at the time of retirement, have completed five years or more of creditable service; for all present and future special service retirees who qualify under the "rule of 80" (i.e., when a combination of age at retirement plus years of creditable service equals 80); and for all disability retirees, with the provision that since the group insurance is continued with waiver of premium to age 65, the $1,000 death benefit does not become applicable until the group insurance ceases;

1/ Participated in morning session; joined afternoon session at point indicated in minutes.
2/ Withdrew from afternoon session at point indicated in minutes.

(2) to increase the normal pension formula, including special service retirement on an acturial equivalent basis, to 1 per cent of the first $4,800 of final average salary plus 1-3/4 per cent of the excess of such final average salary for each year of creditable service, and to increase the disability pension formula to 1-1/2 per cent of final average salary for each year of creditable service with a minimum of 30 per cent of final average salary;

(3) to provide for the use by the Retirement System of an interest rate of 3-1/2 per cent per annum for valuation purposes and for crediting interest on employee contributions (in this connection, the Subcommittee endorsed the decision of the Retirement Committee to adopt the 1951 Group Annuity Tables using a two-year set-back for women); 1/

(4) to raise the salary break-point used in the normal pension formula from $4,200 to $4,800 in order to integrate it with Social Security;

(5) to establish a spouse's benefit in the case of death in active service, permitting the surviving widow or dependent widower to have the option of selecting the normal benefits provided for death in active service by the Retirement System or, in lieu thereof, a life pension equal to that which would be received by such survivor had the employee retired on the date of death and selected the 50 per cent joint and survivorship option;

(6) to remove the $25,000 maximum now applicable to the death benefit provided by the Retirement System upon death in active service;

(7) to provide an optional benefit on deferred retirement by permitting an employee who retires after attaining age 50 with at least 10 years of service and elects to defer payment of his allowance to elect either a 100 per cent or a 50 per cent joint and survivorship option under which the beneficiary would receive the same benefit payable on the pensioner's death as would have been payable had he elected such option on an immediate retirement allowance at the time of his retirement;

1/ This recommendation was approved by the Board on February 17, 1964.

(8) to require five years of creditable service to make employees hired after the adoption of this change and retiring at age 65 eligible for payment by the employing Banks of two-thirds of the share of premiums for hospitalization, surgical, and major medical coverage, and apply the "rule of 80" to determine the eligibility of special service retirees, including those already retired, for such payments; and

(9) to provide for the equitable distribution of excess earnings of the Retirement System to active members, pensioners and their beneficiaries, and the employing Banks, by the allocation of such earnings on a pro-rata basis, after the interest rate is increased to 3-1/2 per cent and the reserve for income equalization and the reserve against investments have reached prescribed maximums, to the retirement reserve account, annuity accumulation account, and pension accumulation account.

In addition the Conference of Presidents approved the discharge of accrued liability arising from the proposals through a lump sum payment (approximately $4.1 million for the post-retirement death benefit, and $2.4 million for other benefits).

The memorandum presented evaluations of these proposals, and background information was contained in various attached papers. On the basis of its analyses, the Division recommended that the Board indicate to the Conference of Presidents the following informal views regarding the proposals:

(1) disapproval on grounds of cost (implementation of this recommendation contemplated a cash payment of approximately $4.1 million to fund accrued liability, and an addition to the Reserve Banks' contributory rate equal to .12 per cent of pay roll);

(2) no objection in principle (some upward revision of the pension formula being considered desirable in order to provide benefits more nearly comparable to those arising from thrift or profit-sharing plans commonly offered in private industry), but some concern about the relatively large retirement benefit in the normal pension formula for higher-salaried employees;

(3) (Board action already taken);
(4) no objection;
(5) no objection;
(6) no objection to raising maximum death benefit from $25,000 to $40,000;
(7) no objection;
(8) agreement with objectives (no revision of Rules and Regulations of Retirement System involved);
(9) no objection.

At the beginning of today's discussion the Division of Personnel Administration distributed a supplemental memorandum stating that the principal reason for recommending disapproval of proposal (1), for a $1,000 post-retirement death benefit, was the cash payment of approximately $4.1 million required to fund accrued liability; except for the negative weight of that payment, there were deemed to be adequate reasons for favorable consideration of the proposal. Statistics were cited to indicate the extent to which private organizations offered such benefits: of 53 firms surveyed, all but 6 provided such a benefit, and the great majority provided an amount greater than $1,000. It was suggested in the memorandum that, as an alternative to the cash payment, the benefit might be made available by financing it on a group life insurance basis. This possibility had been discussed with Mr. Buck, the Retirement System's Consulting Actuary, who was of the opinion that the .12 per cent addition to the Reserve Banks' contributory rate that had been contemplated in the original terms of the proposal would pay for the necessary addition to present group insurance contracts, except for certain administrative expenses. However, Mr. Buck's recommendation was that the benefit be

provided on a life insurance basis through the Retirement System. By doing so, the administrative expenses (estimated at about 4 or 5 per cent of premium) might be avoided. The Division recommended that the Board consider indicating that, while it did not approve the post-retirement death benefit on the terms contemplated in proposal (1), it would consider a recommendation for such a benefit to be financed on a group life insurance basis either through the Retirement System or with an insurance company.

At today's meeting the Division also distributed a table relating to recommendation (2). The present pension formula provided by the Reserve Banks' contributions, based on the average salary of the "high five" years, that is, the 5 consecutive years of service during which an employee received his highest pay, was 3/4 of 1 per cent of the first $4,200 plus 1-1/2 per cent of salary in excess of $4,200. Recommendation (2) would provide a formula of 1 per cent of the first $4,800 of final average salary (final average being defined as the "high five" under the Rules and Regulations of the Retirement System; and the increase from $4,200 to $4,800 being contemplated by recommendation (4)), and 1-3/4 per cent of the amount of salary in excess of $4,800. The Division regarded the 1-3/4 per cent formula as unduly favorable to employees with higher salaries and therefore, in the table distributed at this meeting, suggested an alternative computation based on a formula of 1 per cent of the first $4,800 and 1-5/8 per cent of salary above $4,800, which it was believed

would result in more nearly equal improvement of benefits for all salary levels.

Governor Balderston distributed a table that brought out that increases in the Reserve Banks' contribution rate of .12 per cent of pay roll for the post-retirement death benefit on a group insurance basis, .14 per cent for the spouse's option called for by recommendation (5), and an estimated 1.60 per cent for calculating the normal pension formula at a rate of 1-5/8 per cent for the amount of salary in excess of $4,800, would involve a total increase in contribution rate of 1.86 per cent of pay roll, which was very little more than the decrease of 1.83 per cent that would result from the adoption of a regular rate of interest of 3-1/2 per cent (embodied in recommendation (3) and approved by the Board on February 17, 1964). Governor Balderston's table also noted that he would not approve a cash payment of $4.1 million to fund accrued liability for the recommended $1,000 post-retirement death benefit, and that he proposed a limitation upon the total benefit package of 80 per cent of "high-five" average salary.

Mr. Sprecher referred to the request made by the Board on February 17, 1964, that the Division of Personnel and the Legal Division explore the question whether it might be advisable for Governors Mitchell and Daane to abstain from voting on the Retirement System proposals since they either were or might be beneficiaries of any improvement of benefits that might be adopted. Studies of the circumstances had disclosed no

compelling reason for abstention. From a practical standpoint, the probabilities of resumption by Governors Mitchell and Daane of their Reserve Bank service and participation in any improvement in Retirement System benefits that might now be adopted seemed somewhat remote. Hypothetically, at some future time there might be four or more members of the Board having Federal Reserve Bank service, and if they should disqualify themselves from voting on a Retirement System matter, there would not be a quorum of the Board remaining.

Mr. Hackley commented that an objective study of possibilities embraced not only recognition that Governors Mitchell and Daane might resume Federal Reserve Bank service at some future time, but that other present (or future) members of the Board who had not previously served with the Banks might conceivably enter that service. As a practical matter, this and the considerations mentioned by Mr. Sprecher would weigh against disqualification, but that would not prevent a member from abstaining if he thought it proper to do so.

Secretary's Note: Governors Mitchell and Daane subsequently abstained from participating in the action taken on the Retirement System proposals.

At the Board's request, Mr. Johnson reviewed the evolution of the Retirement System proposals, following which there was a general exchange of views regarding the proposed $1,000 post-retirement death benefit.

Governor Robertson commented that he found more merit in this proposal than in some of the others in that it provided a benefit to individuals in the lower ranks. It seemed to him that the Retirement System should provide this benefit, but he would suggest doing so on the group insurance basis suggested in the Division of Personnel Administration's supplemental memorandum rather than through a method that involved a cash payment of over $4 million.

Governor Daane expressed agreement with Governor Robertson's view, remarking that this was a benefit the lower-income people should have if it could be provided without the $4 million outlay.

Governor Mills commented that it seemed merely subterfuge to use an increase in the Reserve Banks' rate of contribution to finance the proposed death benefit on an insurance basis through the Retirement System. If financing was to be accomplished through the Retirement System, it would seem better to fund the accrued liability, but the proper function of the Retirement System was not to provide life insurance. He would not object, however, if the Board should suggest the acceptability of a proposal to provide the death benefit on a group insurance basis under contract with an insurance company.

Governor Robertson also expressed the view that the proposed benefit was an insurance matter rather than a retirement matter, and that financing through the Retirement System seemed inappropriate.

Mr. Johnson responded that the possibility of financing through the Retirement System had been suggested because of the administrative

expenses, estimated at 4 to 5 per cent of the premium, that would be incurred in providing the benefit through a rider to the present group insurance contract. The Retirement System in a sense was already geared for handling insurance matters, in that for death in active service it provided a payment equal to a year's salary - an insurance-type benefit, though financed from the Retirement System's own funds rather than through contract with an insurance company. He then drew comparisons between the proposed post-retirement death benefit and the extent to which the Civil Service Retirement System provided somewhat similar benefits.

Governor Mitchell observed that financing the proposed post-retirement death benefit either through funding or through group insurance with a commercial carrier would involve defrayal of the expense by the Federal Reserve Banks, and that to the extent that Retirement System funds were used, there would be that much less to finance other benefits.

Chairman Martin questioned whether the alternative possibilities would really effect any saving over the longer run as compared with paying the $4.1 million to fund accrued liability.

Governor Balderston then outlined his philosophical approach to the combination of benefits suggested in the table he had distributed. He was in favor of bringing Federal Reserve Bank benefits up to the community level and what was considered good current practice, as nearly as possible, but with a minimum of increase in the present Bank contribution rate. He also felt that the proposed 1 and 1-3/4 per cent formula for normal pensions

was too heavily favorable to high-salaried, long-service personnel. This difficulty had been solved, in his mind, by the Personnel Division's suggestion of a 1 and 1-5/8 per cent formula, which would reduce the addition to the Banks' contribution rate from 1.75 per cent (which would be called for by the 1 and 1-3/4 per cent formula) to 1.60 per cent, thus leaving some leeway for spouse's option and the post-retirement death benefit. He was not in favor of the cash payment of over $4 million to fund the latter benefit; he considered that such a payment for the purpose of the post-retirement death benefit alone would be hard to justify, even though the last time there had been an adjustment in retirement benefits about $8.3 million had been paid. He had a great deal of sympathy with the exception taken by Governor Mills to providing the death benefit on an insurance basis through the Retirement System. It was a straight insurance matter that was incompatible with the basic function of the Retirement System and ought to be handled by an insurance company.

The tenor of further discussion was generally favorable to the proposed $1,000 post-retirement death benefit, if financed through group insurance under contract with an insurance company.

Mr. Johnson then commented on the proposed revision of the normal pension formula, which had been framed with a view to providing for Federal Reserve Bank retirees benefits at a level comparable to community practice, including the thrift or profit-sharing plans typically included in the latter but not considered appropriate for adoption by the Federal

Reserve Banks. He also commented on the alternative proposal of the Division of Personnel Administration, which had in mind not only reasonable comparability with community practice, but also about the same degree of improvement of benefits for all salary levels, it having been felt that the 1 and 1-3/4 per cent formula would be unduly favorable to higher-salaried employees.

There ensued a discussion of the structure, level, and sources of the proposed pension benefits as compared to those provided by Civil Service and by current community practice.

During this discussion Governor Mitchell expressed the view that comparison with community practice rather than with Civil Service benefits should be the primary guide.

Governor Daane observed that in the employment market the Reserve Banks competed with organizations such as large banks and insurance companies. He asked whether the 1 and 1-3/4 per cent formula would be on the rich side, from that standpoint, or would leave the Reserve Banks still somewhat on the short side. Response was made that the formula appeared to be possibly somewhat on the rich side.

Governor Mills suggested that the fundamental question had to do with the appropriate pension for Federal Reserve Bank retirees and whether it could be afforded. At issue also was the question whether employees of long service and high salary should retire at a higher percentage of their "high-five" years of employment than did individuals with lower

salaries. A consideration bearing upon the latter question was that presumably those who received higher salaries contributed to the System more in the way of capacity and energy than did their lower-paid associates.

Governor Balderston responded that the higher contribution of personal capabilities was presumably recognized in the higher salaries paid such individuals year by year.

Governor Mills remarked that as a practical matter there would be extremely few retirees at the highest salary levels who would have forty years' service.

Governor Mitchell remarked that it would not bother him if the Federal Reserve retirement plan was richer than average. In his view, the Federal Reserve should offer better retirement terms in order to attract and keep people with high capabilities rather than to head for mediocrity. He wished the Reserve Banks were more competitive for highly-qualified employees, and he did not see why the System's retirement benefits should be less favorable than those offered by competing private industries. He regarded the present benefits as definitely unfavorable in comparison with retirement plans of the larger commercial banks.

Governor Daane indicated that he had had several occasions to observe at first hand that Federal Reserve Bank retirement benefits were not competitive with those offered by larger banks. If the intent was to attract capable people, or at least not to lose them, the 1 and 1-3/4 per cent formula would not be out of line in terms of the current market.

Governor Balderston commented that his recommendation that the total benefit package be limited to 80 per cent of "high-five" average salary was based partially on the thought that if criticism should be leveled at Federal Reserve retirement benefits, he would want to feel that his position was fortified by the stipulation of a ceiling in the benefits formula.

Mr. Johnson then made explanatory comments on each of the remaining proposals. Queries by members of the Board, to which the staff responded, indicated no particular disagreement as to the merits of proposals (4), (5), (7), and (8).

The ninth recommendation, which Mr. Johnson next discussed, contemplated that after crediting income from investments at the future rate of 3-1/2 per cent and bringing reserve accounts to their prescribed maximum, any accumulation of earnings be distributed under a dividend plan to active members, pensioners and their beneficiaries, and the employing Reserve Banks. On a pro rata basis, the bulk of such a distribution would go to the contributing Banks, a small annuity would be added to the benefit of pensioners and beneficiaries on the basis of the actuarial table, and active members would benefit by having a larger annuity purchased at retirement. Mr. Buck favored this plan, believing that it might relieve some of the pressure that had been brought to bear in the past for increasing the benefits of those already retired because of rises in the cost of living subsequent to retirement.

Mr. Johnson responded to several questions by members of the Board relating to the proposed distribution of excess earnings, following which he commented on the recommendation of the Conference of Presidents that a lump sum of approximately $6 million be paid to the Retirement System to fund accrued liabilities arising from the proposals. Of this sum, he noted, $4.1 million was for the post-retirement death benefit, for which the Division of Personnel Administration had suggested alternative financing.

The meeting then recessed and reconvened at 2:30 p.m., with the same attendance as at the morning session except that Chairman Martin was not initially present.

Governor Balderston, reverting to the discussion at the morning session of the proposal to distribute excess Retirement System earnings, noted that it had been suggested that instead of such distribution, any excess earnings be allowed to continue to accumulate.

Governor Robertson asked why excess earnings should not be used to reduce the Reserve Banks' contributions.

Governor Mills commented that, once reserves had reached their specified maximums (which he was inclined to consider over-sized), there was a question as to where any further accumulation of earnings should be applied. In his view, Governor Robertson had raised a real point. As Governor Mills understood it, adoption of the new mortality tables in effect gave credit to increased longevity without calling on members for

increased contributions. The heart of the present proposals was the one to increase the normal pension formula from 3/4 and 1 per cent to 1 and 1-5/8 or to 1 and 1-3/4 per cent without at the same reducing the rate of contributions by the Reserve Banks. It seemed to him an important consideration that the package of proposals, with the adjustments made back and forth, including the spouse's benefit, and assuming that the post-retirement death benefit, if adopted, would be financed through group life insurance, resulted in only a small increase in the Reserve Banks' rate of contributions. This was reassuring, but it was nonetheless noteworthy that the Reserve Banks would not receive any benefit through a reduction in their contribution. In his view, special care should be taken to be sure that the benefits in the form adopted were merited in order to bring the Federal Reserve Retirement System into reasonable conformance with private pension and benefit plans and that they were also in reasonable balance with Civil Service benefits.

Governor Shepardson raised the question why the cash payment that would be necessary to fund accrued liability for the total benefit package should not be paid out of any accumulation of excess earnings, to which Governor Mills responded that as a practical matter the excess of earnings over amounts needed for maintaining reserves would apparently be narrow. He continued with comments on the level of Retirement System reserves, the extent to which they needed to be built to specified maximums, and their past administration.

There followed a general discussion of such reserves and the extent to which it was probable that excess reserves would be available for distribution in the form of dividends, if such a course should be decided upon.

As to the first recommendation in the package of proposals, for a post-retirement death benefit of $1,000, it was the unanimous view that the proposal as submitted should be rejected, but with an indication that the Board would consider a proposal to provide a similar benefit through group insurance with a private carrier.

The second recommendation was then presented, proposing a normal pension formula of 1 per cent of salary up to $4,800 and 1-3/4 per cent of salary above $4,800, for each year of creditable service; the alternative proposed by the Division of Personnel Administration called for a formula of 1 and 1-5/8 per cent. There ensued renewed discussion of comparisons between the pensions that would be provided to Federal Reserve employees under the two formulas and those provided under Civil Service retirement. It was observed that there were relatively few retirees of long service at the lowest salary levels, due to normal age and advancement patterns. It was suggested also that employees in higher-salaried positions were more unfavorably situated vis-a-vis opportunities in private industry, even with the distribution of benefits under the 1 and 1-3/4 per cent formula.

After further remarks, it was agreed to reserve proposal (2) for decision after Chairman Martin had joined the meeting.

Recommendations (4), (5), and (7) were then presented, and unanimous approval of each was indicated by the members of the Board. No objection was expressed to recommendation (8), which involved no change in the Rules and Regulations of the Retirement System.

When proposal (6) was presented, calling for removal of the $25,000 limit on the active service death benefit, it was suggested that a vote be taken instead on the recommendation of the Division of Personnel Administration that the limit not be removed entirely, but instead be increased to $40,000.

Governor Mills indicated that he was somewhat bothered by the relationship between this proposal and that in (5), spouse's benefit. Under present benefits, the $25,000 maximum active service death benefit plus group life insurance were in a sense intended to provide an estate that would care to a certain extent for an employee's family. Under the new proposals, the spouse's benefit was directed toward the same purpose, which raised in his mind a question whether the maximum active service death benefit should be increased to $40,000. However, he considered such a benefit more consistent with private pension plans; while Civil Service retirement did not have it, it did have a spouse's benefit. On balance, Governor Mills would approve, though with slight reservations.

Governor Robertson stated that he would vote against the proposal. He would not remove the $25,000 limit, nor would he increase it to $40,000.

Governors Shepardson and Balderston having expressed a favorable position, the proposal to increase the limitation on the active service death

benefit from $25,000 to $40,000 was approved, Governor Robertson dissenting.

Proposal (9), calling for a distribution of excess earnings of the Retirement System, was unanimously rejected, although there was a suggestion that the Board might be willing to have the question raised again for consideration if and when there was a clear need for action.

At Governor Balderston's request, Mr. Sherman then commented on procedures. On a Retirement System matter of this kind, the positions taken today normally would not constitute formal approval or disapproval; the proposals considered favorably would be placed before the Trustees of the Retirement System at their June meeting and would then be returned to the Board for final action. Certain action by the boards of directors of the Reserve Banks also would be required. There might also be a question, he suggested, whether the Board would want to ask the Conference of Presidents to study further the matter of the normal pension formula.

Chairman Martin joined the meeting at this point, and for his information Governor Balderston reviewed the status of consideration of the proposals.

Discussion then reverted to proposal (2), and Governor Mills stated that he had no objection to the 1 and 1-3/4 per cent pension formula. However, if the Board majority was disposed to prefer the 1 and 1-5/8 per cent formula, that would also be acceptable to him.

Governor Robertson said that he would disapprove benefits that were more generous than those provided by Civil Service. He would approve proposals that would bring Federal Reserve Bank benefits up to Civil

Service, but he considered the latter an adequate criterion. He had sympathy for the 1 and 1-5/8 per cent formula, because it would eliminate one of the bases on which he otherwise disapproved, namely, that the 1 and 1-3/4 per cent formula would give relatively more favorable treatment to higher-salaried employees than to lower-salaried employees. At the conclusion of the discussion, if it took such a turn, he might want to cast an affirmative vote for the 1 and 1-5/8 per cent formula, but as of the moment he would simply disapprove the 1 and 1-3/4 per cent formula.

Governor Shepardson expressed himself in favor of the 1 and 1-3/4 per cent formula, modified to specify the 80 per cent ceiling on total benefits as suggested by Governor Balderston. Governors Mitchell and Daane also indicated that, if voting, they would favor the 1 and 1-3/4 per cent formula.

Governor Balderston stated that he would favor the 1 and 1-5/8 per cent formula on the basis that it would tend to equalize the improvement of benefits for high- and lower-salaried employees.

Governor Mitchell then withdrew from the meeting.

Chairman Martin stated that he would vote for the 1 and 1-3/4 per cent formula. As to other proposals that had been voted on in his absence, he joined in the majority position.

After further discussion, Governor Balderston's suggestion for a limitation on total retirement allowance to 80 per cent of final average

salary was accepted, with the understanding that the calculation would exclude any supplemental benefits the employee might purchase for himself.

The positions taken by the Board on the proposals submitted for its consideration by the Presidents' Conference therefore were as stated in the letter written to the Chairman of the Conference on April 10, 1964, a copy of which is attached to these minutes as Item No. 1. These positions were taken with Governors Mitchell and Daane abstaining. As to the other members of the Board, the position stated in the letter on each proposal reflected unanimous agreement, except that (1) Governors Balderston and Robertson dissented from indicating that the Board would approve an increase in the normal pension formula to 1 per cent of the first $4,800 of final average salary plus 1-3/4 per cent of the excess of such final average salary for each year of creditable service, and (2) Governor Robertson dissented from indicating that the Board would approve an increase from $25,000 to $40,000 in the maximum benefit provided in case of death in active service.

It was understood that the Board therefore would not interpose objection to the cash payment necessary to fund the accrued liability resulting from amendments to the Rules and Regulations of the Retirement System to effectuate the proposals that it had been indicated the Board would approve. It was further understood that the Board's Annual Report for 1964 would reflect the fact that such a payment had been made.

It was noted that the Conference of Presidents had also considered and rejected several other retirement benefit proposals, and the suggestion

was made that the Conference might like to have an expression as to whether the Board concurred in those rejections. It was agreed that it would be indicated that the Board had noted the rejected proposals and had no comment. Governor Robertson, however, stated that he would have been in favor of one of the rejected proposals, providing for early retirement at less than full actuarial discount. In his view such a provision, similar to one included in Civil Service benefits, was of interest to many Federal Reserve employees.

Messrs. Johnson, Sprecher, and Hart then withdrew.

Question under section 32 (Items 2 and 3). On March 27, 1964, the Board deferred for further consideration when more members of the Board would be available a distributed memorandum dated March 24, 1964, from the Legal Division, regarding the application of section 32 of the Banking Act of 1933 to service by Robert W. Winthrop as a director of First National City Bank of New York and as a partner in the firm of Wood Struthers & Winthrop, New York, New York. A detailed analysis of the underlying circumstances was contained in the memorandum, on the basis of which the Division recommended a finding that Mr. Winthrop's service as a director of a member bank was prohibited by law. A draft of letter to the Federal Reserve Bank of New York was attached to the memorandum. The Division also suggested that, if the Board adopted the recommendation, the substance of the letter be published in the Federal Register and the Federal Reserve Bulletin.

After discussion, the letter was approved unanimously, with the understanding that its substance would be published as suggested. A copy of the letter is attached as Item No. 2, and a copy of the ruling as published in the Federal Register is attached as Item No. 3.

The meeting then adjourned.

Secretary's Note: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board the following actions relating to the Board's staff:

Appointments

Helen O. Cooke as Statistical Clerk, Division of Research and Statistics, with basic annual salary at the rate of $4,495, effective the date of entrance upon duty.

Mack Richardson Rowe as Chief, Economic Graphics Section, Division of Data Processing, with basic annual salary at the rate of $9,980, effective the date of entrance upon duty.

Salary increases, effective April 12, 1964

Name and title	Division	Basic annual salary From	To
	Office of the Secretary		
Zoe Gratsias, Secretary		$ 6,285	$ 6,460
	Legal		
Cora Lee Hatch, Legal File Clerk		6,110	6,285
	Research and Statistics		
Barbara A. Bosworth, Statistical Clerk		4,355	4,495
Suzanne D. Courtright, Statistical Assistant		4,690	4,850
Jean C. King, Technical Editor		7,260	7,490

Salary increases, effective April 12, 1964 (continued)

Name and title	Division	Basic annual salary From	To
	International Finance		
Thomas M. Klein, Economist		$12,495	$12,880
	Examinations		
Robert F. Achor, Review Examiner		12,110	12,495
John N. Lyon, Review Examiner		12,110	12,495
John M. Poundstone, Review Examiner		12,110	12,495
	Administrative Services		
John C. Chisolm, Cafeteria Laborer		3,305	3,410
Virginia F. Gums, Charwoman		3,515	3,620
Mary E. Sanders, General Assistant		8,180	8,410

Merritt Sherman
Secretary

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

Item No. 1
4/7/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 10, 1964.

CONFIDENTIAL (FR)

Mr. Alfred Hayes, Chairman,
Conference of Presidents of the
Federal Reserve Banks,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Hayes:

The Board of Governors has given consideration to the action of the Conference of Presidents, as reported in your letter of January 31, 1964, in approving recommendations of its Subcommittee on Personnel contained in the Subcommittee's November 25, 1963, report entitled "Study of the Retirement System of the Federal Reserve Banks and Related Fringe Benefits." The action of the Conference of Presidents was reported in greater detail in the minutes of a special meeting held on January 28, 1964, which minutes were also before the Board.

The Board is prepared to approve amendments to the Rules and Regulations of the Retirement System of the Federal Reserve Banks that would carry out certain of the proposals of the Conference of Presidents as set forth hereafter, provided they are modified as indicated in this letter and are approved in such modified form by the Board of Trustees. These would include actions to:

(1) Increase the normal pension formula, including Special Service retirement on an actuarial equivalent basis, to 1 per cent of the first $4,800 of final average salary plus 1-3/4 per cent of the excess of such final average salary for each year of creditable service, provided that a maximum limitation of 80 per cent of final average salary is placed on the total allowance of any retiree at time of retirement, including pension (before optional modification, conversion, or actuarial reduction), normal annuity, and total Social Security benefit but excluding additional annuities provided by the member's voluntary contributions. Approval would also include an increase in the disability pension formula to 1-1/2 per cent of final average salary for each year of creditable service with a minimum of 30 per cent of final average salary.

(2) Integrate the salary break point used in the normal pension formula with Social Security by raising such break point from $4,200 to $4,800.

(3) Establish a spouse's benefit in the case of death in active service, permitting the surviving widow or dependent widower to have the option of selecting the normal benefits provided for death in active service by the Retirement System or, in lieu thereof, a life pension equal to that which would be received by such survivor had the employee retired on the date of death and selected the 50 per cent joint and survivorship option.

(4) Remove the $25,000 maximum now applicable to the death benefit provided by the Retirement System in the case of death in active service, provided that a new maximum of $40,000 is established.

(5) Provide an optional benefit on deferred retirement by permitting an employee who retires after attaining age 50 with at least 10 years of service and elects to defer payment of his allowance to elect either a 100 per cent or a 50 per cent joint and survivorship option under which the beneficiary would receive the same benefit payable on the pensioner's death as would have been payable had he elected such option on an immediate retirement allowance at the time of his retirement.

In acting on the foregoing proposals, the Board did so with the understanding that the accrued liability resulting from the adoption of any such amendments would be discharged by a lump sum payment by the Federal Reserve Banks to the Retirement System. The Board noted without objection the plan to make such amendments effective July 1, 1964, when new rates of contribution by the employing Banks would be established.

Two of the proposals of the Conference of Presidents relating to the Retirement System were not considered favorably:

(1) The Board is not prepared to approve a proposal for the establishment within the Retirement System of a $1,000 post-retirement death benefit. However, the Board would consider a proposal to make available such a death benefit (with the qualifying requirements as stipulated in the recommendation of the Presidents' Subcommittee on Personnel), provided at a reasonable rate on a group life insurance basis through an insurance company.

(2) The Board is not prepared, at this time, to approve a proposal for distribution of excess earnings of the Retirement System.

Since the Board of Governors previously advised the Conference of Presidents, by letter dated February 17, 1964, that it (1) interposed no objection to the adoption by the Retirement System of the mortality tables identified as the 1951 group annuity tables using a two-year setback for women; (2) concurred in the principle that annuities of present members of the Bank plan should not be reduced as a result of the adoption of these tables; and (3) approved increasing the regular rate of interest from 3 to 3-1/2 per cent, no further Board action is necessary on these matters.

One of the proposals of the Conference of Presidents does not concern benefits provided by the Retirement System; namely, to require five years of creditable service in the case of employees hired after the adoption of this change and retiring at age 65 in order for them to be eligible for payment by the employing Banks of two-thirds of the share of premiums for hospitalization, surgical, and major medical coverage, and apply the "rule of 80" to determine the eligibility of Special Service retirees, including those already retired, for such payments. The Board approves this proposal, and a revision of the Board's outstanding letters to the Reserve Banks, as contained in the loose-leaf service, is being prepared for early distribution.

In its consideration of the foregoing matters, the Board noted that the Conference of Presidents at its special meeting on January 28 had reviewed a number of suggested changes in the Retirement System that had been considered but not recommended by its Subcommittee on Personnel. The Board has no comment to make with respect to these changes.

Very truly yours,

Merritt Sherman,
Secretary.

c.c.: Mr. Frederick L. Deming
Mr. Marcus A. Harris
Mrs. Valerie R. Frank
Mr. Thomas A. Timlen, Jr.

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

Item No. 2
4/7/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 8, 1964.

Mr. Howard D. Crosse, Vice President,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Crosse:

This refers to your letter of October 3, 1963, in which you called the Board's attention to the possibility that section 32 of the Banking Act of 1933 ("section 32") might prohibit the interlocking service of Mr. Robert W. Winthrop as a director of First National City Bank of New York and as a partner in the firm of Wood Struthers & Winthrop ("Partnership"), successor to two partnerships, Robert Winthrop & Co. ("Winthrop"), and Wood, Struthers & Co. ("Struthers"), all located in New York City.

As described below, a corporate affiliate ("Corporation") of Partnership has been formed, the stock in which is owned by the partners other than Mr. Winthrop in proportion, allowing for Mr. Winthrop's absence, to their respective partnership interests. You also point out that the practice of forming corporate affiliates of brokerage firms, in order that the affiliates may carry on an underwriting business with limited liability and other advantages, has become rather widespread in recent years, and that other cases may arise where a partner in such a firm may desire to serve at the same time as director of a member bank.

The Winthrop partnership had been the subject of periodic reviews by your Bank for several years, and had been found not to be primarily engaged in business of the kinds described in section 32 ("section 32 business"). The Struthers partnership was determined to be so engaged in 1948, and the indication was that the firm had continued to be so engaged since that time.

On October 30, 1962, Mr. Winthrop's attorney submitted to the Board's staff a draft memorandum on a proposal by the Winthrop partnership to acquire the stock of a securities corporation with a view to obtaining staff views on whether the partnership, in such event, should be regarded as "primarily engaged" in section 32 business, with the result that Mr. Winthrop would be forbidden by that section and by the Board's Regulation R to continue to serve as

director of a member bank. The memorandum stated that to the extent possible, separate quarters would be provided for the proposed corporation, separate personnel employed, and only certain members of the partnership, not including Mr. Winthrop, would serve as officers and directors of the corporation. Despite these measures, the Board's staff felt that the partnership probably should be regarded as so engaged if the proposal were carried out, and advised Mr. Winthrop's attorney informally of this conclusion.

Subsequently, a somewhat altered proposal was put into effect. By arrangement with the Struthers partnership, a corporate affiliate of that partnership, Corporation, with the legal title of Wood, Struthers & Co., Inc., was formed, and the underwriting business formerly carried on by Struthers was transferred to Corporation. The two partnerships then merged to form Partnership, and stock in Corporation was acquired by the partners other than Mr. Winthrop. Two of the three directors and "some" of the principal officers of Corporation are partners in Partnership (although Mr. Winthrop is neither a director nor an officer of Corporation). Mr. Winthrop's attorney gave him a written opinion (a copy of which was enclosed with your letter) to the effect that, under this arrangement, Mr. Winthrop would not himself be engaged in section 32 business, a conclusion with which the Board agrees. The letter continued, however, by stating that:

> "There remains, then, only the question whether the Partnership can be said to be engaged in the securities business to such an extent that it would be improper for you to act as a member thereof [while remaining a director of a member bank]. While it is impossible to predict precisely how the Board of Governors of the Federal Reserve System would interpret Section 32, particularly with reference to the relationship between the Partnership and the Corporation, it is my view that the facts described above do not warrant the conclusion that the Partnership is engaged in activities prohibited to a bank director by Section 32."

The Board agrees that the material question is whether the relationship between Partnership and Corporation is such that the two should be regarded as a single entity for purposes of section 32. You will recall that under the language of the section, ". . . no partner . . . of any partnership . . . primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve at the same time as . . . [a] director . . . of any member bank . . .", with certain exceptions not applicable here. In view of the fact that Corporation is admitted to be "primarily engaged" in section 32 business, a finding that the two are one entity for the purposes of the statute would mean that Mr. Winthrop would be forbidden to serve as director of a member bank, if the one entity is so engaged.

Rule 321 of the New York Stock Exchange ("the Exchange") governing the formation and conduct of affiliated companies of member organizations is material to the decision of this question. Under paragraph .15 of that rule:

> "Since Rule 314 provides that each member and allied member in a member organization must have a fixed interest in its entire business, it follows that the fixed interest of each member and allied member must extend to the member organization's corporate affiliate. When any of the corporate affiliate's participating stock is owned by the members and allied members in the member organization, such holdings must at all times be distributed among such members and allied members in approximately the same proportions as their respective interests in the profits of the member organization. When a member or allied member's interest in the member organization is changed, a corresponding change must be made in his participating interest in the affiliate."

Although you have been informed that Mr. Winthrop received special permission from the Exchange not to own any of the stock of Corporation, it appears that the rule would apply to the remaining partners. Moreover, other paragraphs of the rule forbid transfers of the stock, except under certain circumstances to limited classes of persons, such as employees of the organization or estates of decedent partners, without permission of the Exchange.

From the history of the transaction described in your letter of October 3, 1963, and in the opinion letter enclosed therewith, it is clear that Corporation was formed in order to provide Partnership with an "underwriting arm". Rule 321 of the Exchange makes it clear that the partners (other than Mr. Winthrop) are required to own stock in Corporation because of their partnership interest, would be required to surrender that stock on leaving the partnership, and that incoming partners would be required to acquire such stock. It is significant that Rule 321.15 speaks of a corporate affiliate such as Corporation as a part of the "entire business" of a member organization.

On the basis of the foregoing, the Board concludes that Partnership and Corporation must be regarded as a single entity or enterprise for purposes of section 32.

The remaining question is whether the enterprise, as a whole, should be regarded as "primarily engaged" in section 32 business. A letter of March 17, 1964, from Mr. Winthrop, enclosed with a letter from your Bank of March 18, states that the total dollar volume of section 32 business of Corporation during the first eleven months of its operation

was $88.96 million. The gross income from section 32 business was $0.37 million, and represented about 7.9 per cent of the income of Partnership. Staff of your Bank has advised the Board's staff informally that the size of the section 32 income of Corporation is due to special costs, and to the condition of the market for municipal and State bonds during the past year, a field in which Corporation specializes. Corporation is listed in the directory of North American Securities Dealers, and holds itself out as having separate departments to deal with the principal underwriting areas in which it functions.

In view of the above information, the Board concludes that the enterprise consisting of Partnership and Corporation is "primarily engaged" in section 32 business. Accordingly, the partners in Partnership, including Mr. Winthrop, are forbidden by that section and by the Board's Regulation R to serve as officers, directors, or employees of any member banks.

It will be appreciated if your Bank will advise Mr. Winthrop and his counsel of the views of the Board, and supply them with copies of this letter. Two copies are enclosed for your convenience. You may also wish to advise Mr. Winthrop and his counsel that the substance of this letter will be published as an interpretation of the Board in the Federal Reserve Bulletin and the Federal Register.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosures

TITLE 12 - BANKS AND BANKING

Item No. 3
4/7/64

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. R]

PART 218 - RELATIONS WITH DEALERS IN SECURITIES UNDER SECTION 32, BANKING ACT OF 1933

Securities Affiliate of Brokerage Firm

§ 218.108 Interlocking relationship involving securities affiliate of brokerage firm.

(a) The Board of Governors was asked recently whether section 32 of the Banking Act of 1933 ("section 32"), 12 U.S.C. § 78, prohibits the interlocking service of X as a director of a member bank of the Federal Reserve System and as a partner in a New York City brokerage firm ("Partnership") having a corporate affiliate ("Corporation") engaged in business of the kinds described in section 32 ("section 32 business").

(b) Section 32, subject to an exception not applicable here, provides that "No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank . . .".

(c) From the information submitted it appears that Partnership, a member firm of the New York Stock Exchange, is the successor of two prior partnerships, in one of which X had been a partner. This prior

Partnership had been found not to be "primarily engaged" in section 32 business. The other prior partnership, however, had been so engaged. By arrangement between the two prior firms, Corporation was formed chiefly for the purpose of carrying on the section 32 business of the prior firm that had been "primarily engaged" in that business, which business was transferred to Corporation. The two prior firms were then merged, and the stock of Corporation was acquired by all the partners of Partnership, other than X, in proportion to the respective partnership interests of the stockholding partners. The information submitted indicated also that two of the three directors and "some" of the principal officers of Corporation are partners in Partnership, although X is not a director or officer of Corporation.

(d) It is understood that the practice of forming corporate affiliates of brokerage firms, in order that the affiliate may carry on the securities business (such as section 32 business) with limited liability and other advantages, has become rather widespread in recent years. Accordingly, other cases may arise where a partner in such a firm may desire to serve at the same time as director of a member bank.

(e) On the basis of the information presented, the Board concluded that X, in his capacity as an "individual", was not engaged in section 32 business. However, as that information showed Corporation to be "primarily engaged" in section 32 business, the Board stated that a finding that Partnership and Corporation were one entity for the purposes of the statute would mean that X would be forbidden to

serve both the member bank and Partnership, if the one entity were so engaged.

(f) Paragraph .15 of Rule 321 of the New York Stock Exchange governing the formation and conduct of affiliated companies of member organizations states that:

> "Since Rule 314 provides that each member and allied member in a member organization must have a fixed interest in its entire business, it follows that the fixed interest of each member and allied member must extend to the member organization's corporate affiliate. When any of the corporate affiliate's participating stock is owned by the members and allied members in the member organization, such holdings must at all times be distributed among such members and allied members in approximately the same proportions as their respective interests in the profits of the member organization. When a member or allied member's interest in the member organization is changed, a corresponding change must be made in his participating interest in the affiliate."

(g) Although it was understood that X had received special permission from the Exchange not to own any of the stock of Corporation, it appeared to the Board that Rule 321.15 would apply to the remaining partners. Moreover, other paragraphs of the Rule forbid transfers of the stock, except under certain circumstances to limited classes of persons, such as employees of the organization or estates of decedent partners, without permission of the Exchange.

(h) The information supplied to the Board clearly indicated that Corporation was formed in order to provide Partnership with an "underwriting arm". Under Rule 321 of the Exchange, the partners (other than X) are required to own stock in Corporation because of their partnership interest, would be required to surrender that stock

on leaving the partnership, and incoming partners would be required to acquire such stock. Furthermore, Rule 321 speaks of a corporate affiliate, such as Corporation, as a part of the "entire business" of a member organization.

(i) On the basis of the foregoing, the Board concluded that Partnership and Corporation must be regarded as a single entity or enterprise for purposes of section 32.

(j) The remaining question was whether the enterprise, as a whole, should be regarded as "primarily engaged" in section 32 business. The information presented stated that the total dollar volume of section 32 business of Corporation during the first eleven months of its operation was $89 million. The gross income from section 32 business was less than half a million, and represented about 7.9 per cent of the income of Partnership. The Board was advised that the relatively low amount of income from section 32 business of Corporation was due to special costs, and to the condition of the market for municipal and State bonds during the past year, a field in which Corporation specializes. Corporation is listed in a standard directory of securities dealers, and holds itself out as having separate departments to deal with the principal underwriting areas in which it functions.

(k) In view of the above information, the Board concluded that the enterprise consisting of Partnership and Corporation was "primarily engaged" in section 32 business. Accordingly, the Board stated that the partners in Partnership, including X, were forbidden

by that section and by this Part 218 (Reg. R), issued pursuant to the statute, to serve as officers, directors, or employees of any member banks.

(12 U.S.C. 78)

Dated at Washington, D. C., this 9th day of April, 1964.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(SEAL) (Signed) Merritt Sherman

Merritt Sherman,
Secretary.