Minutes for June 11, 1964

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin _WM_

Gov. Mills _J_

Gov. Robertson _R_

Gov. Balderston _CCB_

Gov. Shepardson _CNS_

Gov. Mitchell _GM_

Gov. Daane _WD_

Minutes of the Board of Governors of the Federal Reserve System on Thursday, June 11, 1964. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Bakke, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Holland, Associate Director, Division of Research and Statistics
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Sprecher, Assistant Director, Division of Personnel Administration
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Potter, Senior Attorney, Legal Division
Mr. Young, Senior Attorney, Legal Division
Mr. Sanders, Attorney, Legal Division
Mr. Collier, Assistant to the Director, Division of Bank Operations
Mr. McClintock, Supervisory Review Examiner, Division of Examinations

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

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

	Item No.
Letter to State Street Bank and Trust Company, Boston, Massachusetts, approving the establishment of a branch near Longwood Avenue and Brookline Avenue.	1
Letter to Southern Bank and Trust Company, Richmond, Virginia, approving the establishment of a branch on East Belt Boulevard, Chesterfield County.	2
Letter to Central Savings Bank and Trust Company, Monroe, Louisiana, approving the establishment of a branch in West Monroe.	3
Letter to First State Bank, Loraine, Texas, waiving the requirement of six months' notice of withdrawal from membership in the Federal Reserve System.	4
Letter to the Presidents of all Federal Reserve Banks regarding hospitalization, surgical, and major medical coverage for active and retired employees. (The letter as approved included certain editorial changes in the draft that had been distributed.)	5

Application of Meadow Brook National Bank (Item No. 6). There had been circulated a memorandum dated June 1, 1964, from the Division of Bank Operations, regarding the application of The Meadow Brook National Bank, Jamaica, New York, to carry reduced reserves. Under the terms of Regulation D, Reserves of Member Banks, the bank was required to carry reserve city bank reserves because it had a branch in a reserve city (New York City), even though its head office was not in a reserve city. The Federal Reserve Bank of New York, in a letter of May 18, 1964, recommended that the application be approved, on the ground that the applicant was primarily a retail banking institution obtaining the major portion of its loans and deposits from suburban areas; that its interbank demand deposits were only 5 per cent of its total demand deposits; that its annual turnover rate of demand deposits was well below that of the large New York City banks; and that its activities in the markets for Federal funds, Treasury bills, and bankers' acceptances were only nominal when compared with such activities of the large city banks. Although the Reserve Bank recognized that Meadow Brook's over-all size (demand deposits of $316 million) was an adverse circumstance, it concluded that the other considerations cited were sufficient to justify approval. The Division of Bank Operations, however, believed that there were not sufficient grounds for approving the application. Size had been also the only circumstance adverse to the application of Franklin National Bank, Franklin Square, New York, for permission to carry reduced reserves, which the Board had recently denied. A draft of letter to Meadow Brook National that would reflect the Division's recommendation of denial was attached to the memorandum.

In summary comments, Mr. Farrell indicated that the Division's principal reason for disagreement with the conclusion reached by the New York Reserve Bank was that, in addition to Franklin National and the applicant bank, there were four other member banks that carried reserve city bank reserves because they had branches in reserve cities, although their head offices were not in reserve cities (one of these four banks also had applied for permission to maintain reduced reserves and had been denied by the Board).

After discussion, the letter to The Meadow Brook National Bank expressing denial of its application was approved unanimously. A copy of the letter is attached as Item No. 6.

Messrs. Daniels, Collier, and McClintock then withdrew from the meeting.

Undivided profits (Item No. 7). There had been distributed a memorandum dated June 10, 1964, from Mr. Hackley, regarding a proposed interpretation that would state, for reasons indicated, the Board's opinion that undivided profits do not constitute "capital," "capital stock," or "surplus" for the purposes of provisions of the Federal Reserve Act. Pursuant to the understanding at the meeting on May 21, 1964, the proposed interpretation had been sent to the designated representatives of the Treasury Department, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation for comment, under the so-called "Dillon procedure." The Corporation, in a letter of June 9, 1964, stated its concurrence in the Board's position. A letter of June 5 signed by the Administrative Assistant to the Comptroller of the Currency, after citing the Comptroller's conflicting ruling in the Manual for National Banks, expressed agreement with the Board's statement that, for purposes of lending limits, the question was one for determination under State laws as to State banks and under the National Bank Act as to national banks, and offered no comment regarding the proposed interpretation of various sections of the Federal Reserve Act as they applied to State member banks.

During comments based on the memorandum, Mr. Hackley stated that, since no reasons had been presented by the other agencies for changing or modifying the conclusions approved by the Board at its May 21 meeting, the interpretation would be issued in the usual manner if the Board had no objection.

After a discussion during which a change in wording suggested by Governor Robertson was agreed upon, the interpretation was approved unanimously for transmission to the Federal Reserve Banks and for publication in the Federal Register and in the next issue of the Federal Reserve Bulletin. A copy of the interpretation, in the form in which it was published in the Federal Register, is attached as Item No. 7.

Mr. Goodman, Assistant Director, Division of Examinations, then joined the meeting.

Regulation A (Item No. 8). There had been distributed a memorandum dated June 4, 1964, from Mr. Hackley, regarding a revision of Regulation A, tentatively entitled Advances by Federal Reserve Banks, that might be adopted in the event of enactment of pending legislation, proposed by the Board, to liberalize provisions of present law regarding collateral for Federal Reserve Bank advances. In a letter of August 22, 1963, the Board had asked the Federal Reserve Banks for comments on a first draft of a revised Regulation A; the matter was also considered at meetings of loan officers of the Reserve Banks. Attached to the memorandum was a summary and analysis of comments of the Reserve Banks and of their loan officers, from which it appeared that there were 5 principal issues for determination by the Board at this time:

(1) Should a revision of Regulation A in the event of enactment of the pending legislation include specific guides or standards as to the nature and amount of collateral? The Reserve Banks strongly opposed the inclusion of any such specific standards in the Regulation itself, preferring that such standards appear in general policy statements to be issued by the Board or in the operating circulars of the Reserve Banks, which might be modified from time to time in the light of experience. Attached to the memorandum was a draft of letter regarding standards with respect to collateral that might be sent to the Reserve Banks at the time of adoption of the revised Regulation A should the Board be disposed to concur in the view of the Reserve Banks on this point.

(2) Should a single rate be fixed for all advances, regardless of type or maturity of collateral, or should differential rates be established? In general, the Reserve Banks preferred a single rate, rather than a higher rate for advances secured by paper with a maturity of more than 18 months, for example, or a lower rate for advances secured by Government obligations.

(3) Should the present Foreword to Regulation A, setting forth general principles governing borrowings from the Reserve Banks, be made an integral part of the Regulation? While some of the Reserve Banks

opposed making the so-called "general principles" a part of the Regulation, there seemed to be no sound reason why that should not be done. On the contrary, such a change would seem desirable if eligibility requirements were repealed and reliance were to be placed primarily on the soundness of loans and the appropriateness of member bank borrowings.

(4) In light of the proposed repeal of all statutory maturity requirements, should the Regulation be more specific in limiting advances to periods of 15 days, except where a borrowing bank gave good reason for longer maturities? It was believed that advances for periods of more than 15 days should be permitted only where a member bank demonstrated a need for such longer maturities in conformity with the "general principles"; but recognition might be given to the possibility of renewals consistent with such general principles.

(5) Should the present negotiability requirement be eliminated from the Regulation? If security was endorsed or assigned in a manner that would effectively protect the lending Reserve Bank, there seemed to be no need for a requirement of negotiability. That requirement might be eliminated even if the pending legislation should not be enacted.

Attached to the memorandum were a proposed revision of the first draft of Regulation A, prepared in light of the comments received from the Reserve Banks, and memoranda indicating the substantive and textual changes included in the revision.

At the Board's invitation, Mr. Hackley made summary comments, after which Governor Robertson asked for further light on the view expressed by both the Legal Division and several of the Federal Reserve Banks that the requirement of negotiability might be dropped from the Regulation. Since at one time someone had believed negotiability essential, Governor Robertson thought it should not be eliminated now without good reasons. He asked what types of non-negotiable paper might be accepted as collateral, and how such paper would be liquidated by a Reserve Bank, if necessary.

Staff responses mentioned, as examples of possible non-negotiable collateral, real estate paper, some term loan agreements as conventionally drawn, and paper now acceptable for advances under section 10(b) of the Federal Reserve Act. It was also pointed out that non-negotiability of collateral would have very little significance in terms of liquidation of the advance, since the chief recourse was the note of the borrowing member bank, with the collateral purely a secondary aspect of the transaction.

Mr. Hackley added that the staff felt the emphasis of the Reserve Banks should not bear so heavily upon the objective of protecting themselves against loss, possibly thus dulling awareness of their role in affording credit facilities to member banks. Of course, it was expected that the Reserve Banks would take reasonable precautions, but negotiability of collateral was not viewed as essential in this connection.

Governor Mills expressed the opinion that the Reserve Banks were taking a somewhat adolescent approach in their desire to discard the negotiability requirement. Title to collateral should be taken, if for no other reason than to insure that the Reserve Bank, as the lender, assumed the dominant position. As he saw it, there was an element of danger in the thought Mr. Hackley had expressed that the Reserve Banks should place their central bank function first and their position as lender second. A Reserve Bank was in fact a lender and, viewed in the long term, should perform that function in its true context and not as a Lady Bountiful.

Mr. Hexter reiterated the thought that negotiability ordinarily was not extremely important, so far as collecting a loan was concerned, since it was usually no harder to enforce a non-negotiable instrument than a negotiable one. He added that the only virtue of negotiability was that it served to cut off certain equitable defenses that could otherwise be raised to defeat collection, but since these defenses were seldom raised, and there was, in any event, the primary recourse of the borrowing bank's note, negotiability of collateral was not really important. Although negotiability did serve to facilitate the flow of financial instruments, there seemed to be not much to lose by eliminating the requirement and something to be gained by adding flexibility to the Regulation.

Governor Mills agreed that there was always a note connected with the transaction, but he expressed the view that it was necessary to go beyond the note to give the lender collateral protection. He thought that perfectibility of collateral was the point.

Governor Mitchell concurred with Governor Mills' point as to perfectibility and observed that up to the present time it had been possible to obtain Government securities as collateral, whereas in the future a member bank might not have Governments to offer but would have to use other types of instruments from its portfolio, which must be something the Reserve Bank would be able to sell if necessary to recover on its advance.

Mr. Hackley said that he had not intended to imply that the Reserve Banks should not protect themselves, and he noted that the Board had made exemptions from the negotiability requirement in the past.

Governor Robertson asked whether, if there was no pending proposal to amend the law, the Legal Division would still recommend that the Regulation be amended to eliminate the negotiability requirement; in other words, would it be of sufficient importance for action independent of other proposed changes?

Mr. Hackley responded that he believed he would recommend such action, in view of the responses of the Reserve Banks and the fact that in proposing the legislation the Board had indicated an intent to eliminate unnecessary requirements.

Governor Robertson then asked the reason for retaining in the proposed revision of Regulation A a provision that in general a Reserve

Bank should limit the amount of collateral it requires to the minimum consistent with policy.

Governor Mills reviewed the background in which some Reserve Banks, during one period of Federal Reserve history, had tended to be over-severe in the amount of collateral they required. The theory behind the suggested provision to which Governor Robertson had referred was that, without being soft-hearted, the Reserve Banks should be admonished not to take more collateral than was necessary to protect their position as lender.

Governor Robertson acknowledged the historical background but expressed the view that the admonition might better be in the suggested letter of general instructions to the Reserve Banks rather than in the Regulation. It seemed to him that by having the provision in the Regulation, a member bank might feel that tender of minimum collateral was a matter of right in its dealings with the Reserve Bank. However, he observed that since the provision was part of the present Regulation in only slightly different form, this might be a valid argument for not taking it out at the present time.

Mr. Farrell remarked that another background circumstance, in addition to those mentioned by Governor Mills, was the criticism heard in years past of variations from one Reserve Bank to another in administration of the discount windows. It could be argued that, both to promote uniformity and to discourage excessive collateral demands, the provision ought to be in the Regulation, rather than being put in the letter and thus left more to discretion. Governor Shepardson expressed accord with this view.

Governor Robertson suggested that the same ends would be better served by having the provision in the letter, which had the force of Board instructions to the Banks. In response to a comment by Mr. Farrell that the burden of enforcement would then be upon the examining process, Governor Robertson said that, as he saw it, this was where it should be.

Governor Mitchell commented that to him the issue was one that would not arise unless a Reserve Bank encountered trouble in connection with an advance, and in such an event it would be important to have the provision in the Regulation.

Governor Mills suggested that the provision be left in the proposed revision of the Regulation for the time being and that the point be revived for discussion when Messrs. Hackley and Holland met again with the Reserve Bank loan officers.

Mr. Farrell observed that the discount officers of the Reserve Banks had displayed an attitude of wanting a blank check to handle extensions of credit to member banks as they saw fit. He also commented on the desirability of requiring that a member bank provide information to justify any renewal of an advance beyond the normal 15 days contemplated by the Regulation, as well as on the relatively lenient attitude that had been displayed in some Federal Reserve Districts toward continuous borrowing on the part of certain member banks. He suggested that the proposed letter to the Reserve Banks emphasize that standards for borrowing had not changed and that tendencies to continuous borrowing on the part of member banks should be given prompt attention.

Chairman Martin joined the meeting at this point.

Governor Mitchell remarked that the pending legislation recommended by the Board was written in terms that reserved to the Board complete administrative authority to fix standards for discounting; he would not be surprised to see a departure from that philosophy in the ultimate legislation, if enacted. As to the instances of continuous borrowing mentioned by Mr. Farrell, Governor Mitchell believed that under the present Regulation A seasonal credits were being extended on the same basis as 15-day credits. He thought this was essentially wrong and that a distinction should be made between money market borrowing for the purpose of adjusting reserve position and seasonal borrowing, the latter justifying at least partial recourse to Federal Reserve discount windows. Underlying this distinction were deep implications of monetary policy and public relations, and in his view it would be preferable to recognize two different discount policies in the Regulation, one for reserve adjustment and the other for seasonal borrowing. Seasonal borrowing, which would be done mostly by small banks, might be allowed for maturities of three to six months, perhaps at an increased rate. Money market borrowing might also be allowed, but only on a 15-day basis. Allowing seasonal borrowing would make many friends for the System among banks that needed such facilities, and so long as the service kept to the nature of a central bank function, it would not contravene monetary policy. Governor Mitchell believed that more thought should be given to the Regulation from this standpoint.

Governor Shepardson commented that repetitive borrowing over a period of time might be justifiable, for example, to carry sound ranching operations over a drouth period. On the other hand, he understood that many cattle feeders had lost money and were continuing to feed against a declining market, which would seem to call for an adjustment by the cattle business rather than extensions of Federal Reserve credit to enable continuance of a basically unsound situation. He considered it important to know the explanation of instances of continuous borrowing: in some circumstances it was justifiable, and in others it was not. He thought that any instances of continuous borrowing should be given attention in examination reports.

Governor Mills expressed the view that the proposed Regulation allowed a sufficient area of discretion to discount officers; he had doubts that all of the Reserve Banks would always use that discretion wisely, but that was a matter to be picked up through the examination process.

Mr. Holland observed that it was difficult to write a regulation, or even an operating letter, so finely as to control all aspects of operation. A set of guiding principles that would be checked by examiners ought to be workable. As now drawn, the proposed Regulation would permit either seasonal or adjustment borrowing. What was needed was a better understanding of the range of discretion intended for the Reserve Banks, and a means of getting an early indication when member banks were running into problems. The setting of 15-day borrowing as the norm was frequently criticized and had cost a great deal of public relations and good will from member banks that could not understand why such a rule was imposed when it was well known that their paper ran for more than 15 days.

During further discussion, Governor Robertson suggested that the provision in section 201.3 of the proposed Regulation that would allow advances for more than 15 days upon "a satisfactory showing of need for a longer maturity that would not be inconsistent with the general principles" set forth in section 201.1 be revised to a positive basis, thus indicating that both longer term advances and renewals might be granted when consistent with those principles.

Governor Mitchell said that he would like to go a little further and indicate that advances for 6 months would be available for seasonal needs. It was his understanding that many banks - small ones in particular - that needed advances for such a period did not even approach the Federal Reserve discount officers, because the Regulation provided that the normal term for advances was 15 days. From the standpoint of public relations, it would be an advantage to System membership if the Regulation recognized a right to borrow for 6 months. Also, extension of justified seasonal credits would put the reserves where they were needed, and the provision could be managed in such a way that it would not be abused by large banks. Rather than have 15-day credits extended when it was known that renewals would be necessary, there should be an explicit determination by the lending officer of the probable length of the borrowing. With the purpose of the borrowing, seasonal or for adjustment, established at the beginning, the issue would not arise whether the borrowing was continuous or not. The need for longer credits was one reason why he was somewhat in favor of differential rates. He would like to see provision for two or three maturities, which he believed would be helpful in policing the Regulation.

Governor Robertson stated that he would be a little fearful of specifying that advances might be made for 6 months, since this might result in such term becoming the standard. However, perhaps something could be added to take care of the kind of emergency that arose from crop failures.

Governor Shepardson observed that limiting 6-month maturities to unusual situations would not meet the need. In many cases, the need for an advance for 6 months did not arise from unusual circumstances, but rather was attributable to the nature of the business of the borrowing member bank.

Governor Mills expressed the view that until there was a basis of experience under the Regulation, it would be wise to leave discretion to the Reserve Banks. The banks having consistent need for 6 months' credit were concentrated in a few Federal Reserve Districts, and it would seem preferable to depend on the discount officers in those districts to use appropriate judgment based on their experience and familiarity with regional business, rather than to invite applications for longer terms of credit that could quickly become interpreted as a standard rather than an exception. It would seem desirable that any exception not be made to fit the unusual but to fit the great multitude of circumstances, and then allow enough leeway for discretion to extend the exception to the unusual.

After further discussion, Mr. Hackley suggested that the second sentence of section 201.1(d) of the revised draft of the Regulation might be changed to read somewhat along the following lines: "Federal Reserve credit is also available for longer periods if the borrowing bank makes a satisfactory showing that longer-term credit is necessary as a result of national, regional, or local difficulties or because of circumstances involving only the borrowing bank." There was general agreement with this suggestion.

Governor Mills expressed regret that the proposed Regulation did not contain specifications to assist the Reserve Banks in encouraging liquidity on the part of member banks, which he believed could have been done by indicating what maturities would be eligible for advances on a preferential basis. It had disturbed him that the Reserve Bank lending officers had taken the position that liquidity should not be their concern, but that of bank examiners. He regarded it as faulty thinking for one operating department of a Reserve Bank to contend that any aspect of sound banking was solely the concern of another department.

Mr. Holland expressed agreement with Governor Mills but observed that the view that member bank liquidity was primarily the concern of the examining function was also held by some Reserve Bank Presidents. In a second meeting of Board representatives with Reserve Bank discount officers, the thinking of the latter had been in the direction of operating under guidelines in the Regulation, subject to review and report by the examiners. Mr. Holland then described efforts being made by the Reserve Banks looking toward training Discount Department personnel to appraise various types of collateral.

Governor Robertson urged that there be continuous working arrangements to insure coordination and cooperation between Federal Reserve examiners and discount officers.

At the conclusion of the discussion it was understood that a revised draft of Regulation A, incorporating changes based on views expressed at this meeting, would be sent to the Reserve Banks for comment. A copy of the letter transmitting the revised draft to the Federal Reserve Banks, dated June 15, 1964, is attached as Item No. 8.

During the preceding discussion Mr. Noyes, Adviser to the Board, entered the room, and at its conclusion Messrs. Holland and Potter withdrew.

Legislative program. There had been distributed a memorandum dated June 8, 1964, from the Legal Division presenting, pursuant to the Board's request on May 11, 1964, a preliminary outline of a possible legislative program. The memorandum suggested the following subjects for consideration: advances by Federal Reserve Banks; amendments to the Bank Holding Company Act; reserve requirements; interest on deposits; gold reserves of Federal Reserve Banks; foreign currency operations; investments by member banks in foreign banks; underwriting of revenue bonds; loans to executive officers; amendments to the Securities Exchange Act; proposals to meet the coin shortage problem; subpoena and enforcement authority; delegation of authority in regard to bank supervisory functions; and reorganization of Federal bank supervision.

In discussion, Governor Mills expressed an inclination to reduce the list to a minimum of the more urgent needs initially, and to return to consideration of the remaining subjects later. He noted that proposals that had been made for a graduated system of reserve requirements contemplated coverage of demand deposits only; with the total of commercial bank time deposits now roughly equal to the total of demand deposits, he questioned that limitation.

Governor Robertson suggested deleting from the list the proposals relating to investments by member banks in foreign banks and to delegation of supervisory authority. Also, he believed that proposals to alleviate the coin shortage should be left to the Treasury Department. He was in favor of more liberal limitations than had been proposed for loans to executive officers for purchase of their residences. He had a question, but no strong feelings, regarding proposals dealing with trading in bank securities.

Governor Shepardson stressed the importance of arriving at Board positions on a number of the subjects listed, which had been discussed by the Board from time to time without arriving at official postures.

Governor Mitchell expressed the view that it was particularly important to go forward promptly on proposals regarding reserve requirements and gold reserves, and he would regard the subjects of next importance to be the underwriting of revenue bonds and delegation of supervisory operations. As to reserve requirements, he stated that he was not so concerned about dealing with time accounts, which he regarded as another issue, as he was with developing constructive measures relating to demand deposits and reserve classifications.

Chairman Martin commented that, while gold reserve requirements and delegation of supervisory functions were perhaps not of as much urgency as some of the other topics, it would be well to be prepared with draft legislation on these subjects.

Mr. Hackley observed that the Board had already submitted proposals relating to advances by member banks and to amendments to the Bank Holding Company Act.

After further discussion, it was understood that the Legal Division would proceed to draft legislation concerning the topics discussed according to the priorities indicated.

Messrs. Brill, Farrell, Solomon, Hexter, O'Connell, Shay, Hooff, Goodman, Leavitt, Young, and Sanders then withdrew from the meeting.

Retirement System - 80 per cent limitation (Item No. 9). On April 7, 1964, the Board considered various proposals regarding liberalization of the Bank Plan of the Retirement System of the Federal Reserve Banks that had been approved by the Conference of Presidents. In a letter of April 10 relating to these proposals, the Board had indicated to Mr. Hayes, Chairman of the Conference, that it would be willing to approve a plan for increasing the normal pension formula to 1 per cent of the first $4,800 of final average salary plus 1-3/4 per cent of such salary above $4,800 for each year of creditable service, provided a limitation of 80 per cent was placed on total retirement allowance, 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.

There had been distributed a memorandum dated June 1, 1964, from the Division of Personnel Administration stating that it had become apparent that for present Reserve Bank employees with long service the 80 per cent limitation would create an inequity, in that with such a limitation under the new formula some of those employees would receive less than they would under the present formula without such a limitation. It was therefore proposed to allow current employees their choice of either formula, and a change to that effect in the Rules and Regulations of the Retirement System was being included among others for which the Board's approval would be sought in due course. In the opinion of the Retirement Committee, however, that choice did not completely eliminate discrimination between present employees with long service and recent new or future employees who would retire after long service. The Committee had therefore offered for consideration of the Conference, the Board of Governors, and the Board of Trustees of the Retirement System an alternative amendment to the Rules and Regulations that would in effect be a change in the definition of "normal annuity." At present, normal annuity was based upon required contributions made by the employee during employment; the alternate amendment would base it upon the employee's contributions as if he had contributed during his employment at the required rate of contribution in effect at the date of his retirement. This would mean that, if the contribution rate at retirement was 4 per cent of salary above $4,800, all contributions that had been made in excess of that rate would be refunded either in cash or in the form of an additional annuity. The Conference of Presidents had discussed this proposed amendment at its meeting on May 26, 1964, but took no action.

The memorandum from the Personnel Division explored various circumstances bearing upon the proposed amendment and concluded that, with the contemplated choice of formula, there were not sufficient reasons for the Board to depart from the 80 per cent limitation.

After summary comments by Mr. Sprecher, members of the Board raised questions, to which the staff responded, regarding application of the 80 per cent limitation to certain individual cases. A circumstance having special bearing was that any present employee with more than 30 years' service would have been given some credit, toward which he had not contributed, for years prior to 1934, when the Retirement System was established.

At Chairman Martin's request, Mr. Sherman commented on his exploration of the question with Mr. Treiber, who had represented Mr. Hayes at the May 26, 1964, meeting of the Conference of Presidents. As Mr. Treiber saw it, the problem of inequity under the 80 per cent limitation specified by the Board arose because retirement allowances under the Bank Plan were based on three components: the pension provided by the Bank; the annuity provided by the employee's own contribution plus that provided by the Bank's contribution for service prior to 1934; and

Social Security, half of which was paid for by the Bank and half by the employee. Social Security benefits were set by Congress and could not be touched by the Board or the Retirement System. The position of Messrs. Hayes and Treiber was that the whole concept of prior service credit was that the funds contributed by the Bank became the employee's money, and they thus reasoned that it would be improper and perhaps illegal to take away any of the annuity that would be provided by those funds. Therefore, if neither the Social Security benefit nor the annuity could be reduced by the 80 per cent limitation, the entire cutback would have to come out of the pension portion, provided by the Bank. As a result, application of the 80 per cent limitation to the retirement allowance of the employee who would have received more under the proposed new formula would mean that the Bank would have contributed relatively less to his pension benefits than to the pension benefits of employees not affected by the limitation. Messrs. Hayes and Treiber also felt that, because of the structural aspects of the Retirement System, meeting the 80 per cent limitation through downward adjustment of the pension portion of the retirement allowance would exact a heavier penalty on lower incomes than on higher ones. (Mr. Sherman noted that the Actuary for the Retirement System, Mr. Buck, had indicated that he would not advocate the existing structure if the Retirement System were to be set up today, and Dr. McGill, whom the Board had consulted on Retirement System matters, had thought such a structure undesirable.)

While Messrs. Hayes and Treiber could understand why the Board considered a limitation advisable, they believed it would be more equitable to apply a formula against only the pension portion and the half of Social Security benefits that came from Bank contributions, rather than against the combined pension, normal annuity, and total Social Security benefit. They had stated that many private employers had such a plan, with a 60 per cent limitation.

Mr. Sherman pointed out that from 1934, when the Retirement System was set up, until the middle 1950's, employee contribution rates under the Bank Plan ranged up to 7 or 8 per cent or more, depending on age. Employees who had contributed at relatively high rates for many years would have accumulated a sizable annuity fund, though it was true that since the mid-1950's they had contributed only on the portion of their salary above $4,200, unless they had elected to continue the higher payments as a voluntary contribution. For such an employee, Mr. Treiber had reasoned, a downward adjustment of pension to meet the 80 per cent limitation would constitute an inequitable penalty, whether he fell in high or low-salary brackets. Mr. Sherman concluded with the comment that such so-called inequities arose because the new formula for computing retirement allowances, which the Board had indicated it would approve, would result in many allowances well above 80 per cent of final average salary, with the result that the Board had indicated its approval was subject to the over-all limitation of 80 per cent.

Mr. Sherman commented that Mr. Treiber had also pointed out that, aside from current employees who had a long term of service, there would be some continuing effect of the 80 per cent limitation, in that it would tend to encourage early retirement. An employee with about 40 years' service at age 60 might have reached his 80 per cent. If he continued in service to age 65, his retirement allowance would not increase unless there was a further increase in his salary. While he would continue to contribute at the 4 per cent rate, the Bank would be reducing each year the portion of his pension that it would pay, in order to keep within the 80 per cent limitation. Thus, there would be an incentive to retire as soon as the 80 per cent was reached.

Mr. Sprecher then commented on consultations he had had with Mr. Buck, the Actuary for the Retirement System, and with Mr. Harris, Chairman of the Retirement Committee, regarding the possibility of making any adjustments that were necessary in the annuity, or in a combination of the pension and the annuity, to arrive at benefits comparable to those provided by the Board Plan. A difficulty had been encountered, in that under the fixed annuity of the Board Plan the benefits payable at 42 years' service were known, whereas under the variable annuities of the Bank Plan they were not. An arbitrary adjustment applicable to two-thirds of the annuity and one-third of the pension had been considered, but had been deemed of doubtful legality.

Governor Mitchell suggested that, from a welfare standpoint, there might be something to be said for abrogating the 80 per cent rule for retirees below, say, the $7,000 salary level, in response to which Mr. Sprecher observed that treating different salaries differently would be likely to conflict with regulations of the Internal Revenue Service regarding the tax status of pension plans. In reply to another question by Governor Mitchell as to what term of service would call the 80 per cent rule into play in the Bank Plan, Mr. Sprecher indicated that it would be roughly the 40-year mark, although the period would be shorter in some cases.

Governor Mills remarked that, as a practical matter, it seemed to him there was no other choice than to adhere to the 80 per cent limitation, with regret that there would be some inequities and inconsistencies, but with recognition that many present retirees would not get benefits equal to those that future retirees would under the proposed formula and the 3-1/2 per cent funding rate. In his view, it would never be possible to obtain complete equity for every individual, and there were decisions that must be made with respect to the System as a whole.

Chairman Martin observed that perhaps the only way to avoid all inequity would be to have no limit, but this opened the way to some unduly high allowances. Ensuing comments indicated that he, as well as other members of the Board, found such a resort unacceptable.

Another possible recourse would be to apply the limitation only to the pension portion of the retirement allowance but to set it so low that the combined pension, annuity, and Social Security benefit would never exceed 80 per cent of final average salary. Still another possibility would be to re-examine the 1 and 1-3/4 per cent normal pension formula that was expected to be adopted, with a view to dropping it back to a lower rate.

Governor Mills expressed the view that if the Retirement System could operate under the higher formula without at the same time raising the rate of contribution of the employing Banks, it would seem difficult to justify reverting to a lower benefit rate, unless the Board wished to reduce the contribution rates of the Banks below those that had been in effect for some time.

In further discussion of the effect of the 80 per cent limitation on the retirement allowances of long-service employees, Governor Shepardson commented that the 80 per cent limit would apply only under the proposed new formula, and since employees would have the choice of that formula or the present one without the 80 per cent limit, he was unable to see that long-service employees would in any way be deprived.

Governor Mills then requested comparison of the retirement allowances that would be available under the increased pension formula with those provided by Civil Service, in response to which Mr. Sprecher cited various salary levels and terms of service indicating that, for example, at 40 years' service the benefits were roughly parallel through about the $10,000 level, but that at the $20,000 and higher levels Civil Service retirees would not fare quite so well as Bank Plan retirees.

After further discussion, it was agreed unanimously that the 80 per cent limitation on retirement allowances, as expressed in the Board's letter of April 10, 1964, to the Chairman of the Conference of Presidents, should be retained. Governor Robertson, who had withdrawn from the meeting during the discussion, had indicated before leaving that he favored retaining such limitation. A copy of the letter informing the Chairman of the Conference of Presidents of this action is attached as Item No. 9.

Mr. Sherman reported that, before departing for his present European travel, Governor Balderston had expressed his views on several points of principle in the proposals that had been under consideration. First, the Board had wanted to be sure that the Retirement System was financially sound, and assurance on that point had been given as a result of the study made by Dr. McGill. Second, it had been desired that Bank benefits be commensurate with those furnished by good private employers, which had been accomplished through the prospective adoption of the 1 and 1-3/4 per cent pension formula. Third, application of that formula had pointed to the desirability of imposing a top limit on allowances to keep them within the bounds of propriety for quasipublic institutions. Governor Balderston had been of the view that the 80 per cent limitation accomplished this. Fourth, the Reserve System should not be in the position of making a large lump-sum contribution toward payment of accrued liabilities as a result of the increased benefit scale, and use of so-called "excess earnings" to cover such liabilities would avoid payments of that sort.

Retirement System - excess earnings (Item No. 9). Pursuant to action at the meeting of the Board on April 7, 1964, regarding various proposals relating to the Retirement System, the Board stated in a letter of April 10 to Mr. Hayes, Chairman of the Conference of Presidents of the Federal Reserve Banks, that "The Board is not prepared, at this time, to approve a proposal for distribution of excess earnings of the Retirement System." The proposal then under consideration did not include specific procedures to govern distribution. For various reasons Mr. Deming, Chairman of the Board of Trustees of the Retirement System, inquired whether the Board would be willing to consider such a proposal if resubmitted accompanied by suggested distribution procedures. In a letter of April 29, 1964, the Board informed Mr. Deming that it would review such a proposal, with the understanding that this should in no way be considered as a willingness to approve or disapprove.

In a distributed memorandum dated June 5, 1964, the Division of Personnel Administration reported that the Retirement Committee, to which Mr. Deming had referred the question, had submitted details of a proposed plan for distribution of excess earnings with a letter of May 19, 1964, including examples of the effect on retirement allowances. After considering the Committee's report at a special meeting on May 26, 1964, the Conference of Presidents voted to recommend to the Board that (1) an amount be transferred from excess earnings to the Income Equalization Reserve account sufficient to bring it to a level of 3-1/2 per cent of the book value of investments, that being the new rate for valuation purposes and for crediting interest; (2) the 5 per cent limitation on the Reserve Against Investments account be continued; (3) an amount equal to the accrued liability to result from the increased benefits under the Retirement System proposed to become effective July 1, 1964, be transferred from excess earnings to the Pension Accumulation Account; and (4) there be established at this time a policy of distributing annually all earnings in excess of the amounts determined by the actuary to be necessary to maintain the Retirement System reserve accounts at their appropriate levels, such distribution to be prorated on the basis set forth in Exhibit G to the May 19 report of the Retirement Committee. An indication of the Board's views on this recommendation was desired prior to June 16, when the Trustees of the Retirement System were to consider this and other proposed changes in benefits.

The memorandum from the Personnel Division indicated that estimated earnings of $4,898,000 were currently available in excess of the needs of all retirement accounts. If, as recommended, accrued liability (estimated at $2,584,000) resulting from the anticipated increase in the pension formula was paid from that excess, $141,000 of the remainder would be pro rated for credit to the Board Plan and $2,173,000 to the Bank Plan. The latter amount would be distributed on a proportionate basis to the Pension Accumulation Account ($1,169,000), Annuity Accumulation Account ($354,000), and Retirement Reserve Account ($650,000). The credit to the Annuity Accumulation Account would allow a credit to each individual annuity account equal to .8 per cent of the individual account balance - an average of about $16 for each annuitant or, for example, a credit of $80 for an individual with a $10,000 annuity accumulation.

A somewhat detailed analysis of the earnings distribution proposal was set out in the memorandum, on the basis of which the Division of Personnel Administration presented, with evaluating comments, the following alternatives: (1) approval of the plan for distribution of excess earnings, as recommended by the Conference of Presidents at the special meeting on May 26; (2) approval of the payment of accrued liabilities from excess earnings, without approval of the distribution of the remainder; (3) approval of payment of accrued liability from excess earnings and deferment of approval or disapproval of distribution of the remainder; and (4) disapproval of the entire recommendation, with a statement that the Board believed there should be no consideration of distribution of excess earnings. The Division recommended the third alternative, supporting reasons being that (1) the net excess ($2.3 million) remaining after the payment of the accrued liability would not permit a significant distribution to the individual accounts of annuitants, and there could be no distribution to retirees or their beneficiaries at this time; (2) the plan for distribution presented some problems, such as whether the excess earnings prior to retirement should be treated as additional contributions resulting in annuities in excess of the 80 per cent limitation and in much greater percentage increases in retirement allowances for higher salaried than for lower-salaried employees; (3) the Reserve Banks and the Board would have an opportunity to review experience in the next year or so under the recently-approved increase to a 3-1/2 per cent interest rate; and (4) a decision to distribute excess earnings now might be subject to criticism as untimely. It was assumed that, in the event the Board accepted the Division's recommendation of the third alternative, the so-called excess earnings remaining at the present time after payment of accrued liabilities, as well as future such excess earnings, would not be used to reduce the Reserve Banks' rates of contribution, and that suspension of the 5 per cent limitation on the Reserve Against Investments account would continue.

Mr. Sprecher commented on the salient points of the June 5 memorandum, remarking that although the Division favored the third of the alternatives presented for consideration, it could not be said that the recommendation was a strong one.

Governor Mills stated that the third alternative was a logical one, and he would favor it.

Governor Shepardson weighed the second and third alternatives. A consideration against the second, to approve payment of accrued liabilities from excess earnings but not to approve the distribution of the remainder, was that it contemplated placing present and future excess earnings in the Pension Accumulation Account and using them to reduce the contribution rates of the Reserve Banks, thus foreclosing a later reopening of the subject of distributing them to members or retirees. In favor of the second alternative was his feeling that mortality tables had always lagged. With average life expectancy running ahead of the tables, annuitants were in effect already getting a share of excess earnings. Also, such action would conclusively dispose of the matter, whereas under the third alternative - deferring decision - repeated agitation might be expected. On balance, however, the fact that the second alternative would foreclose a later appraisal on the basis of experience under the new funding rate and other changes threw the weight of his preference to the third alternative.

Governor Mitchell expressed concern about increases in the cost of living of present retirees and ways of meeting their needs. He was not familiar with the general practice of private industry in this respect, but he would not want to see Federal Reserve retirees suffer by comparison. Although he did not know what cost-of-living increases would do to the Retirement System's costs, he would not want to set a policy of using so-called excess earnings of the Retirement System to reduce the contributions of the Reserve Banks until the cost-of-living contingency had been considered. That was the only reason he could see for postponing a decision against distribution of the excess earnings that would remain after the payment of accrued liabilities now being incurred. Like Governor Shepardson, Governor Mitchell said he would prefer a final disposition of the question, but on balance his thinking resolved in favor of the third alternative, which could be lived with until 1965, when it was contemplated that the question would again come up.

Chairman Martin also expressed himself in favor of the third alternative.

Mr. Sherman noted that Governor Robertson, before withdrawing from the meeting, had indicated his willingness to accept the third alternative, if that seemed to be the Board's preference, although he had some inclination toward the second.

The third alternative - use of so-called excess earnings to cover accrued liabilities and deferment of a decision on any further distribution at this time - was therefore approved unanimously. Notice of this action was also included in the letter to the Chairman of the Conference of Presidents, a copy of which is attached as Item No. 9.

All members of the staff except Mr. Sherman then withdrew from the meeting.

Appointment of Acting Director. Governor Shepardson noted that the resignation of Mr. Schwartz as Director, Division of Data Processing, had become effective as of the previous day. Pending selection of a new Director, Governor Shepardson recommended that the Board designate W. M. Davis as Acting Director, effective June 11, 1964, to serve for the remainder of 1964 or until a new Director was appointed. Mr. Davis, Assistant Cashier of the Federal Reserve Bank of Atlanta, was on assignment to the Board for a period of approximately six months, and Governor Shepardson had discussed the recommended designation with President Bryan, who was agreeable to it.

Governor Shepardson's recommendation was approved unanimously.

Direct purchase authority (Item No. 10). Chairman Martin stated that he proposed to send to Chairman Robertson of the Senate Committee on Banking and Currency a report on S. 2891, a bill to extend for another two years the authority of the Federal Reserve System to purchase up to $5 billion of special securities direct from the Treasury. The report, which had been requested by Chairman Robertson, would present the same views that Chairman Martin had expressed on a companion bill, H. R. 11499, at a hearing earlier in the day before the House Committee on Banking and Currency.

There being concurrence with Chairman Martin's suggestion, the letter was sent to Chairman Robertson in the form attached as Item No. 10.

The meeting then adjourned.

Secretary

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

Item No. 1
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

June 11, 1964.

Board of Directors,
State Street Bank and Trust Company,
Boston, Massachusetts.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by State Street Bank and Trust Company, Boston, Massachusetts, of a branch on the southwestern side of Longwood Avenue, near the corner of Longwood Avenue and Brookline Avenue, in Boston, Massachusetts, provided the branch is established within two years from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

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

Item No. 2
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 11, 1964.

Board of Directors,
Southern Bank and Trust Company,
Richmond, Virginia.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Southern Bank and Trust Company, Richmond, Virginia, of a branch at 128-136 East Belt Boulevard, Chesterfield County, Virginia, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

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

Item No. 3
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 11, 1964.

Board of Directors,
Central Savings Bank and Trust Company,
Monroe, Louisiana.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Central Savings Bank and Trust Company, Monroe, Louisiana, of a branch on the east side of the 600 block of North Fourth Street, West Monroe, Louisiana, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

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

Item No. 4
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 11, 1964.

Board of Directors,
First State Bank,
Loraine, Texas.

Gentlemen:

The Federal Reserve Bank of Dallas has forwarded to the Board of Governors two letters, one dated May 5, 1964, and the other dated May 22, 1964, both of which are signed by President Herbert Mearse, and resolution dated May 5, 1964, signifying your intention to withdraw from membership in the Federal Reserve System and requesting waiver of the six months' notice of such withdrawal.

The Board of Governors waives the requirement of six months' notice of withdrawal. Under the provisions of Section 208.10(c) of the Board's Regulation H, your institution may accomplish termination of its membership at any time within eight months from the date that notice of intention to withdraw from membership was given. Upon surrender to the Federal Reserve Bank of Dallas of the Federal Reserve stock issued to your institution, such stock will be canceled and appropriate refund will be made thereon.

It is requested that the certificate of membership be returned to the Federal Reserve Bank of Dallas.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 5
6/11/64

S-1916

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 12, 1964.

Dear Sir:

This letter is designed to bring together in a single communication previous Board approvals for employee hospitalization and surgical benefits, as well as major medical insurance coverage, for both active and retired employees; and to advise of recently approved revisions regarding eligibility of retirees for such benefits and coverage. The following Board letters are superseded: March 11, 1946 and August 19, 1952 (F.R.L.S. 3189); June 2, 1959 (S-1699; F.R.L.S. 3190); January 30, 1959 and March 1, 1961 (S-1686 and S-1780; F.R.L.S. 9155).

Pursuant to its March 11, 1946 letter, the Board approved the specific plan of each Federal Reserve Bank for hospitalization and surgical benefits, including the payment by the Reserve Banks of two-thirds of the premium cost, under the general program that had been recommended by the Presidents' Conference on February 25, 1946. The Reserve Banks should continue to submit any significant change in cost or benefits of those plans for Board consideration prior to adoption. However, it is not necessary to submit changes initiated by the insuring organization (Blue Cross Association, other comparable nonprofit organizations, or any other insuror specifically approved by the Board) entailing relatively minor increases in costs or benefits where the Bank is left no alternative but to pay the increased rate or withdraw from group coverage.

The Board also approved the System major medical plan recommended by the Presidents' Conference on May 26, 1959, including the payment by the Reserve Banks of two-thirds of the premium cost. In the interest of maintaining a uniform approach, it is understood that all Reserve Banks will keep their programs within the maximum benefits provided under this approved plan, including any modifications subsequently approved by the Board.

In addition, the Board approved the recommendations of the Conference of Presidents with respect to extending the foregoing coverages of retired employees: for basic hospitalization and surgical benefits, as recommended on November 6, 1958; and for major medical coverage, as recommended on December 13, 1960.

Recently, the Board approved the January 28, 1964 recommendation of the Conference of Presidents to revise the eligibility requirements of retirees and their families for inclusion in the hospital-surgical-medical and major medical coverage as set forth below, and for the payment by employing Federal Reserve Banks of two-thirds of the premium cost, effective on or after July 1, 1964:

A. Service retired employees, with the requirement of five years of creditable service under the Retirement System of the Federal Reserve Banks in the case of employees hired after July 1, 1964.

B. Special service retirees (including those already retired) who qualify under the "rule of 80," meaning any combination of age at time of retirement and total years of service (not limited to "creditable service") that equals at least 80.

C. Disability retirees, with the restriction that major medical coverage will include only employees who retired for disability on or after the varying dates that active employees at the respective Federal Reserve Banks were covered by major medical insurance.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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

Item No. 6
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 11, 1964.

Board of Directors,
The Meadow Brook National Bank,
Jamaica, New York.

Gentlemen:

This relates to the application from your bank, submitted through the Federal Reserve Bank of New York, for permission to maintain the same reserves against deposits as are required to be maintained by banks located outside of reserve cities.

After consideration of the information submitted with your application, the Board of Governors believes that the character of your bank's business, as reflected in the amount of its total demand deposits and its competition with other banks, is more like that of the reserve city banks in New York City than that of banks to which the Board has granted permission to maintain reduced reserves. Accordingly, the Board believes that it would not be justified in granting your application for reduced reserves.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 7
6/11/64

TITLE 12 - BANKS AND BANKING

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. H]

PART 208 - MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

Undivided Profits as "Capital", "Capital Stock", or "Surplus"

§ 208.111 Whether undivided profits may be considered part of capital or surplus of member banks.

(a) The Board of Governors has been presented with the question whether a bank's undivided profits may be considered as part of its "capital stock", "capital", or "surplus" for the purposes of provisions of law imposing requirements or limitations upon member banks of the Federal Reserve System.

(b) It is obvious that undivided profits are not a part of a bank's "capital stock"; and Congress has explicitly indicated in the national banking laws that the more general term "capital" is limited to common stock and preferred stock (12 U.S.C. 51c).

(c) In the banking field, the undivided profits account traditionally represents a fluctuating amount as distinguished from the relatively fixed and permanent amount of a bank's "surplus" or "surplus fund". This distinction has been explicitly recognized by the Supreme Court of the United States:

> "By incorporated banks the term [undivided profits] is commonly employed to designate the account in which profits are carried more or less temporarily, in contradistinction to the account called surplus in which are carried amounts treated as permanent capital, and which may have been derived from payments for stock in excess of par, or from profits which have been definitely devoted to use as capital." Edwards v. Douglas, 269 U.S. 204, 215 (1925)

(d) The Federal banking laws use the terms "undivided profits" and "surplus" as having different meanings. For example, with respect to the admission to membership in the Federal Reserve System of mutual savings banks having no capital stock, the Federal Reserve Act requires such a bank to have "surplus and undivided profits" not less than the amount of capital required for the organization of a national bank in the place in which the savings bank is located (12 U.S.C. 333). Similarly, various provisions of the National Bank Act distinguish between "undivided profits" and "surplus fund". Thus, a national bank may not declare dividends if its losses have exceeded its "undivided profits" (12 U.S.C. 56); and, until a national bank's "surplus fund" equals its common capital, it may not declare dividends unless a specified percentage of its net profits is carried to its "surplus fund" (12 U.S.C. 60).

(e) If undivided profits were regarded as a part of a bank's surplus or "surplus fund", such provisions for transfer of profits to surplus would be meaningless and the application of other provisions would be uncertain and impracticable. For example, subscriptions by member banks to Federal Reserve Bank stock are based upon the amount of the member bank's "capital stock and surplus" (12 U.S.C. 287), so that, if undivided profits were regarded as a part of "surplus", the amount of a bank's subscription to Reserve Bank stock would have to be increased and decreased continuously, an inconvenient and costly procedure that could not have been contemplated by Congress.

(f) It is recognized that the question whether undivided profits may be added to capital stock and surplus in calculating the lending limitations governing member banks is a matter for determination under applicable State law in the case of State banks and under the National Bank Act in the case of national banks, except as further limited by particular provisions of the Federal Reserve Act. For the reasons indicated above, it is the Board's opinion that undivided profits do not constitute "capital", "capital stock", or "surplus" for the purposes of provisions of the Federal Reserve Act, including those that limit member banks with respect to loans to affiliates (12 U.S.C.371c), purchases of investment securities (12 U.S.C. 335), investments in bank premises (12 U.S.C. 371d), loans on stock or bond collateral (12 U.S.C. 248(m)), deposits with nonmember banks (12 U.S.C. 463), and bank acceptances (12 U.S.C. 372, 373), as well as provisions that limit the amount of paper of one borrower that may be discounted by a Federal Reserve Bank for any member bank or accepted as security for an advance to a member bank (12 U.S.C. 330, 345, 347).

(12 U.S.C. 248(i). Interprets 12 U.S.C. 24, 84, 248(m), 287, 330, 335, 345, 347, 371c, 371d, 372, 373, 463.)

Dated at Washington, D. C., this 11th day of June, 1964.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 8
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 15, 1964

Dear Sir:

As you will recall, the Board of Governors by a letter of August 22, 1963, requested the comments of the Federal Reserve Banks regarding an enclosed first draft of a proposed revision of the Board's Regulation A that might be issued in the event of enactment of legislation recommended by the Board (now pending as S. 2706 and* H.R. 8505) to liberalize requirements as to advances by Federal Reserve Banks.

The Board has carefully considered the Comments received from the Reserve Banks, as well as the views of the loan officers of the Reserve Banks expressed at meetings of such officers. In the light of such comments, the Board is now considering a revised draft of such a possible revision of Regulation A in the form enclosed herewith. The principal changes that would be made by this redraft are described in an accompanying memorandum, and an enclosed comparative print shows textual changes that would be made in the present Regulation.

The Board concurs in the view of the Reserve Banks that specific standards regarding collateral for Federal Reserve advances under the pending legislation should be included in policy statements rather than in the Regulation itself. In this connection, there is enclosed a draft of a letter regarding such standards that might be approved by the Board at the time of adoption of a revised Regulation after enactment of the pending legislation.

It seems unlikely that the legislation will be enacted at this session of Congress. However, as a basis for further consideration of the matter and in anticipation of possible Congressional hearings on the pending bills, the Board would be glad to have your comments with respect to the proposed redraft of Regulation A and the suggested draft of letter regarding collateral for Federal Reserve advances.

Very truly yours,

* Should have read S. 2076.

Merritt Sherman,
Secretary.

Enclosures

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

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

Item No. 9
6/11/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 11, 1964.

Confidential (FR)

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

Dear Mr. Hayes:

This refers to Mr. Deming's letter of June 1, 1964, advising the Board of the action of the Conference of Presidents on May 26, 1964, regarding the treatment of so-called excess earnings of the Retirement System of the Federal Reserve Banks and requesting an expression of the Board's views on these recommendations.

Subject to the prior approval of the Board of Trustees, the Board will be prepared to approve the transfer from these earnings of:

(a) an amount sufficient to bring the Income Equalization Reserve account to a level of 3-1/2 per cent of the book value of investments, and

(b) the accrued liability of approximately $2.6 million which results from the increased benefits under the Retirement System proposed to become effective July 1, 1964.

The Board has concluded that it should defer action on the treatment of the remainder of such excess earnings for at least a year, thus affording an opportunity to review the experience of the System under the revised mortality tables and the proposed increase in the regular rate of interest. In this connection, it would be understood that the Retirement System would earmark earnings currently available, as well as future earnings, which are in excess of the actuarial requirements for all of the Retirement System accounts in order that such earnings would not be used for purposes of calculating rates of contribution for the Federal Reserve Banks.

The Board has also reviewed the matter of a limitation on total retirement allowances and continues to believe that the 80 per cent limitation should be applied, as specified in the Board's letter to the Chairman of the Conference of Presidents, dated April 10, 1964.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

cc: Mr. Frederick L. Deming,
Chairman, Board of Trustees,
Retirement System of the
Federal Reserve Banks,
c/o Federal Reserve Bank of Minneapolis,
Minneapolis, Minnesota. 55440

Mr. Marcus A. Harris,
Chairman, Retirement Committee,
Retirement System of the
Federal Reserve Banks,
c/o Federal Reserve Bank of New York,
New York, New York. 10045

Mr. Thomas M. Timlen, Jr.,
Secretary, Conference of Presidents
of the Federal Reserve Banks,
c/o Federal Reserve Bank of New York,
New York, New York. 10045

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 10
6/11/64

OFFICE OF THE CHAIRMAN

June 11, 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 for the Board's views on S. 2891, a bill to extend for another two years the authority of the Federal Reserve System to purchase up to $5 billion of special securities direct from the Treasury.

This direct borrowing authority is an operating convenience that, while seldom used in recent years, has contributed to flexibility in the Treasury's management of the public debt. Its use in the past has avoided needless strains in the banking system immediately preceding tax payment dates. Even when not used, it has enabled the Treasury to operate with lower cash balances than otherwise would have been feasible, and has provided added leeway in timing new offerings. Furthermore, it is always possible that we may find ourselves in an emergency in which the availability of this sort of "standby" financing would be very important.

Borrowing under this authority has been temporary as well as infrequent. It has been confined to its proper role as a useful tool of debt management, and has not been used as a lever to induce financing of Government deficits through unwarranted expansion of Federal Reserve credit.

The statutory provisions which this bill would continue to require that the details of all transactions directly with the Treasury be reported in the Annual Report of the Board of Governors. I should also like to add that such borrowing, when it is outstanding, is reported separately in the weekly statement of condition of Federal Reserve Banks.

The Board recommends enactment of this legislation.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.