Minutes for June 23, 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, June 23, 1964. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Mitchell
Mr. Daane

Mr. Sherman, Secretary
Mr. Bakke, Assistant Secretary
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Davis, Acting Director, Division of Data Processing
Mr. Hexter, Assistant General Counsel
Mr. Furth, Adviser, Division of International Finance
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Goodman, Assistant Director, Division of Examinations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Thompson, Assistant Director, Division of Examinations
Mr. Langham, Assistant Director, Division of Data Processing
Mrs. Semia, Technical Assistant, Office of the Secretary
Miss Hart, Senior Attorney, Legal Division
Mr. McClintock, Supervisory Review Examiner, Division of Examinations
Mr. Poundstone, Review Examiner, Division of Examinations
Mr. Steinberg, Economist, Division of Data Processing

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on June 22, 1964, of the rates on discounts and

advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

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

	Item No.
Letter to Central West Corp., Davenport, Iowa, granting its request for a determination exempting it from all holding company affiliate requirements except those in section 23A of the Federal Reserve Act.	1
Letter to Chairman Hayes of the Conference of Presidents noting without objection an increase in membership dues for Federal Reserve Banks and branches in NABAC, the Association for Bank Audit, Control and Operation.	2

Report on competitive factors (Wellsville-Belfast, New York). There had been distributed a draft of report to the Federal Deposit Insurance Corporation on the competitive factors involved in the proposed merger of Belfast National Bank, Belfast, New York, into The First Trust Company of Allegany County, Wellsville, New York.

Governor Mills suggested that the second sentence of the conclusion of the report, which stated that "The competitive effects of the merger would be adverse," might be deleted as representing too narrow a view, since the Belfast community, which was rural and somewhat unprogressive, might actually benefit from the availability of a larger and more efficient bank with broader competitive facilities than the bank

proposed to be merged had offered. In his view, there were cases, such as the one under discussion, where it was necessary to weigh some loss of competition that would result from the merger against positive benefits to be derived from the ability of the resulting institution to serve banking needs of the community in a more viable and effective manner. Other members of the Board expressed agreement that the sentence in question should be dropped.

The report was then approved unanimously for transmission to the Federal Deposit Insurance Corporation. The conclusion of the report, as approved, read as follows:

> The proposed merger of Belfast National Bank, Belfast, New York, and The First Trust Company of Allegany County, Wellsville, New York, would eliminate the competition existing between the two banks and would result in the further concentration of banking resources of Allegany County in two banks.

Messrs. Thompson and McClintock then withdrew.

Application of Camden Trust Company. There had been distributed a memorandum from the Legal Division dated June 22, 1964, to which were attached drafts of an order and statement reflecting the Board's decision on June 10, 1964, to deny the application of Camden Trust Company, Camden, New Jersey, to merge with Merchantville National Bank and Trust Company, Merchantville, New Jersey.

After a discussion during which suggestions were made for certain changes relating to emphasis and approach, the staff was requested to redraft the statement and to resubmit it for further consideration by the Board.

Valuation of shares of foreign corporations held by Edge or agreement corporations (Item No. 3). At the meeting on June 12, 1964, the Board had considered a distributed memorandum dated May 22, 1964, from the Division of Examinations regarding valuation of shares, for balance sheet and examination purposes, of foreign corporations held by Edge or agreement corporations operating under sections 25 or 25(a) of the Federal Reserve Act. After background and analytical comments, the memorandum had suggested three alternative methods for valuation of such shares, for use according to varying circumstances that might be presented: the first was based on the proportionate interest represented in net capital accounts of the foreign corporation, the second on market value of the shares at current rate of exchange, and the third on acquisition cost. Two accompanying memoranda, also dated May 22, had presented specific questions raised by Bankers International Corporation (a subsidiary of Bankers Trust Company, New York, New York), an Edge corporation, and International Banking Corporation (a subsidiary of First National City Bank, New York, New York), an agreement corporation, involving questions of valuation of foreign shares held by them. The Board acted on the International Banking Corporation matter but deferred adoption of a principle of general applicability regarding valuation of foreign investments pending more extended discussion of the subject. The Board also deferred action on the question raised by Bankers International pending staff revision of a proposed letter that had been attached

to the May 22 memorandum, based on comments made during the course of discussion. A revised draft letter to Bankers International had been distributed under date of June 17, 1964.

The question presented arose from the fact that when the Board, on September 3, 1963, had granted consent to Bankers International to purchase up to 18,239 shares (2-1/2 per cent of outstanding shares) of l'Union des Mines-La Henin, Paris, France, at a cost of approximately $1,861,000, a condition was attached that the Corporation carry the investment on its books at a net amount not in excess of the proportionate share of the book capital accounts of the French bank, after giving effect to the elimination of all known losses. In a letter of September 27, 1963, Bankers International had asked that, in view of the great disparity between the book value and market value of the shares, and for other reasons stated, the condition be rescinded and that it be allowed to carry the investment on its books at cost, offering in support of this request an opinion by Price Waterhouse & Co. The Federal Reserve Bank of New York, in a letter of October 2, 1963, had urged that the request be granted. At the time Bankers International was examined as of February 21, 1964, 16,999 shares of the French bank had been purchased and were carried on the books of Bankers International at $1,577,789; appraisal of the stock in accordance with the condition attached to the Board's consent would require a writedown of $1,131,000.

The first draft of reply to Bankers International had offered alternative language that would (1) require adherence to the condition imposed by the Board at the time the purchase had been authorized, or (2) indicate that, although the Board would not require immediate charge-off or establishment of a valuation reserve to reduce net carrying value, the shares would be appraised in examination reports at the market price, with any net depreciation classified as loss, it being anticipated that the Corporation would use its best efforts to eliminate such loss by charge-off or establishment of valuation reserves as soon as practicable.

The revised draft letter of June 17, after weighing various considerations bearing upon the matter, concluded that in the circumstances the Board was not disposed to require the Corporation to charge off the difference between cost and either net asset value or current market value, but that the Board believed any cash dividends received from shares of l'Union des Mines-La Henin should be set aside into a valuation reserve until such reserve was equal to the difference between cost and current market value.

In summary comments, it was emphasized that the proposed response was intended to be an ad hoc approach to the particular issue presented, rather than a principle of general applicability. Messrs. Goodman and Solomon reasoned that, although valuations based on the pro rata share of the book capital or net asset value seemed fair and appropriate

for investments comprising the entire stock or the majority interest in a foreign corporation, there might be justification for some flexibility in appraisal of minority stockholdings. It was pointed out that the investment here in question, while representing only 2-1/2 per cent interest in the French bank, constituted a sizable portion of the assets of Bankers International. Since the shares had depreciated substantially subsequent to their purchase, it did not seem out of the way to allow Bankers International to set aside a valuation reserve until the difference between cost and market value had been closed. (Mr. Goodman suggested certain clarifying changes in the language of the last paragraph of the revised draft letter to Bankers International, and he also indicated a revision that would specify that all net earnings, rather than all cash dividends received, be set aside in the valuation reserve.)

In response to a question whether the valuation reserve would vary according to market price fluctuations or whether, if the market price rose, the Corporation could withdraw from the reserve, Mr. Solomon replied that accrual of a fairly large amount of reserve was called for, and it seemed likely that before the requirement was fulfilled, the question could be re-examined should such a development occur. When there was some indication of the price at which the long-term market would settle, it should be possible to arrive at a long-term solution.

Governor Daane asked if the Division had had conferences with the staff of the New York Reserve Bank about the matter. Responses

indicated that, although there had not been conferences, it was clear that the Reserve Bank favored rescission of the condition in question.

Governor Mills expressed the view that the proposal of the Division of Examinations seemed to be a practical solution. Being an ad hoc arrangement, it would not bind the Board in other cases.

Governor Daane commented that, although the Division's proposal was intended as only an ad hoc approach to the immediate case, there were some similar questions pending, and for the Board to adopt the proposed position in the case under consideration would, as a practical matter, make it difficult to take a more severe position regarding the other pending cases.

Chairman Martin observed that in his view it would be in order for the Board to proceed with the ad hoc solution proposed in the case under discussion, since some experimentation seemed warranted in this difficult area of valuation.

Mr. Hexter suggested that, if the Board decided to adopt the proposed arrangement, it should be expressly stated in the letter that the Board was not establishing a general principle for application in other similar cases.

Governor Mitchell said that he thought the proposed approach was a practical one. The arrangement would be between the Board and the Corporation and would not be the subject of a public announcement. The question presented was how accurately the balance sheet must reflect

the value of an investment. It could be valued at cost, at some arbitrary appraisal, at net book, or at market. It seemed to him that the practical way was to put the stock on the books at cost and to have a memorandum item as to the net book and the market value, if any. Then, if at some time in the future the examiner felt that cost was no longer the appropriate valuation basis, it could be required that a different value be calculated. Under this approach, it would not be necessary that the books constantly be revised; in his opinion, it did not seem reasonable to require corporate books to be rewritten constantly to reflect changes in market value of investments.

Mr. Goodman remarked that the normal manner of keeping a bank's books did not lend itself readily to the kind of approach Governor Mitchell suggested; customarily, a reserve was set up to bridge any substantial gap between purchase price and current market value.

Governor Mitchell responded that there was a question as to whose judgment was to be accepted that the stock was not worth what was shown on the books. If the net book and the market value were shown in memorandum form, they would be available for the examiner to use in forming a judgment whether an adjusted value was needed. To write down the investment on the basis called for by the Board's original condition, he believed, would cause nothing but trouble.

Mr. Solomon commented that, while what Governor Mitchell had said was not unreasonable, in the present case the fact that the market

price of the stock had been below its cost price since it was purchased was a presumptive indication that Bankers International had bought it near the top of the market. The requirement that a valuation reserve be set aside, and that earnings be retained in that reserve until there was reasonable assurance that the market value was not badly out of line with the cost of the stock, sought to protect the Corporation's capital position.

Governor Robertson stated that his concern was not with the immediate case but with the principle underlying the suggested procedure. As he saw it, the moment the Board permitted a procedure that would, in effect, permit a watered value to be shown for an Edge corporation's assets, there would be difficulty. It was important for the Board to adopt a policy that would require Edge corporations to carry reasonable values on their books. He did not care what method was used, so long as it accomplished the purposes of this principle. In his view, the Board, through thought and through discussion with examiners, should arrive at a basis that was sound for application in every case; as for the immediate problem regarding Bankers International, however, the proposed arrangement seemed perfectly appropriate for the present.

Chairman Martin agreed with Governor Robertson's point as to the importance of establishing a governing principle but observed that it was not easy to know what a sound basis would be. He reiterated the view that a proper solution would require some experimentation. He

thought the Board might proceed to dispose of the pending case as proposed, adopting Mr. Hexter's suggestion for an explicit statement in the letter that the arrangement should not be assumed to govern other similar cases.

Governor Daane reiterated his misgivings that the arrangement would be construed to imply adoption of a principle, notwithstanding the suggested statement to the contrary.

Governor Mitchell expressed the view that the Board already had available all the information needed to decide upon a governing principle, and he did not see why the decision should be postponed.

Mr. Furth commented that banks were destroyed not by what they showed on their books, but by what they did with their funds. It would be dangerous to permit Bankers International to use as profit dividends that were not truly profit in view of the loss the Corporation had suffered on the purchase of the stock. If the Corporation's shares were traded on an exchange, prospective purchasers who might look at the books would get a wrong impression as to what the stock of the French bank was worth, if the books showed its purchase price. The ad hoc solution, retaining earnings until the cost of the stock would more nearly represent a sound value of the asset, could easily provide a basis for a governing principle.

After further discussion approval was given to a letter to Bankers International Corporation in the form attached as Item No. 3.

Governor Mitchell concurred in the action taken, but noted his dissent from the decision that it be merely an ad hoc disposition since in his view the Board had all the facts necessary to establish a general principle.

It was understood that forthcoming cases of a similar nature would be considered on their individual merits but that efforts to arrive at a principle of general application would continue. Governor Mills added that discussions of individual cases should provide a fertile basis for the development of a governing general principle.

Mr. Poundstone then withdrew, and Messrs. Johnson, Director, Division of Personnel Administration, Kelleher, Director, Division of Administrative Services, and Grimwood, Chief, Liaison Office, Office of Defense Planning, entered the room.

Crimes against banking institutions (Items 4 and 5). There had been distributed a memorandum dated June 16, 1964, from the Division of Examinations regarding a report to be made to Chairman Dawson of the House Committee on Government Operations, in response to his request of March 3, 1964, on actions taken to implement recommendations in the Committee's report on "Crimes against Banking Institutions" (House Report No. 1147, 88th Congress, 2d Session; February 20, 1964). In a letter of May 7, 1964, the Federal Reserve Banks were asked for their comments and views on the eight recommendations in the Committee's report. A summary of the Reserve Bank responses was attached to the memorandum.

The subject had also been discussed with the staff of the Federal Deposit Insurance Corporation and at the annual conference of representatives of Reserve Bank Examination Departments. The memorandum commented on each of the eight recommendations and the extent to which the measures called for, or similar ones, either were already in use or reasonably could be adopted. Attached to the memorandum was a draft reply to Chairman Dawson based on the studies that had been made of the Committee's recommendations.

Also attached to the memorandum was a draft of letter to the Presidents of the Federal Reserve Banks that would enclose, for use from the date of receipt, a revised page 16 of the report of examination, Form F. R. 410, that would instruct the examiner to "Comment generally about adequacy of security and controls against external crimes and specifically on any deficiencies noted." Also enclosed, for use in each examination, would be a questionnaire entitled "Security and Controls against External Crimes." The questionnaire, devised in collaboration with the staff of the Federal Deposit Insurance Corporation, had been sent by the Board on May 28, 1964, to the Comptroller of the Currency for comment, with the understanding that, unless within a reasonable time the Comptroller suggested modifications that seemed to merit consideration, the questionnaire would be used by Federal Reserve examiners in the form then presented.

Governor Robertson suggested one substantive change in the draft letter to Chairman Dawson and several others of an editorial nature. His

substantive comment related to the suggestion in the Committee's recommendation 4 that fingerprints of prospective officers, directors, and employees of banks be submitted to the Federal Bureau of Investigation for criminal record checks, concerning which he proposed that the following sentence be added to the letter: "If fingerprinting is to be required, it should be done by legislation applying to applicants for employment in industry generally, and not just to applicants for positions in banks." In his view, such a requirement applicable to banks alone would compound the problem of recruiting personnel.

The letter, with the changes suggested by Governor Robertson, was approved unanimously. A copy of the letter in the form transmitted to Chairman Dawson is attached as Item No. 4. The letter to the Federal Reserve Bank Presidents, a copy of which is attached as Item No. 5, was also approved unanimously.

Emergency relocation arrangements. There had been distributed a memorandum dated June 22, 1964, in which Governor Robertson reported the results of a study he had undertaken pursuant to the Board's action on December 4, 1963, looking toward the establishment of a relocation facility for the joint use of the Board and the Federal Reserve Bank of Richmond. It had been understood that consideration would be given to including an emergency currency vault for servicing Reserve Banks in the eastern part of the country, and that the functions of the Board and the Richmond Bank would be reviewed to determine which, if any, in addition

to those directly related to the operation of the relocation facility, might be usefully transferred to provide a prelocated staff for emegency use. Governor Robertson had been asked to make the review and formulate suggestions.

Governor Robertson had reviewed the Board's functions with the senior staff in order to identify those activities that should be continued in a period immediately following an attack, and also for the purpose of exploring the feasibility of decentralizing certain preattack functions at a location within commuting distance of Washington. Functions identified as crucial in the first thirty days following an attack related to monetary policy; maintenance, restoration, and solvency of the banking system; and assistance to the Reserve Banks and the Treasury. Requirements to fulfill these functions would include dependable communications, a data processing capability, and staff advisers to assist the Board, particularly in the interpretation of economic intelligence.

With respect to the feasibility of prelocating staff advisers, it was Governor Robertson's conclusion, supported by the consensus of the senior staff, that the staff members who would be most urgently required in an emergency were those who were most closely connected with the day-to-day policy responsibilities of the Board. Their transfer outside of Washington, with the exception of the Defense Planning staff, would entail an unacceptable loss of efficiency in the Board's operations. Certain long-range research functions, important to the Board's normal

policy responsibilities but having a low priority postattack, might be transferred with less disruption, but in Governor Robertson's view, such a move would add little to a postattack operational capability in terms of providing a staff competent to advise the Board, or an interim Board, concerning essential postattack operations. In this connection, the most effective solution seemed to him to be an arrangement whereby key personnel at the Richmond Reserve Bank would be thoroughly trained and kept currently familiar with Board functions essential in an emergency, including open market and foreign exchange operations.

Without question, the communications center, consisting of the Federal Reserve leased wire switching center and the emergency Interagency Communication System facilities, could and should be relocated and operated on a continuing basis. It was Governor Robertson's opinion, subject to technical feasibility studies, that the Board's computer could be operated just as efficiently outside of Washington as in the Board's offices, with the added advantage of making a powerful computer system available to the Richmond Bank. Another emergency service would be provided by relocating some printing and duplicating equipment, to be used in normal times for large volume jobs for which speed was not essential. Also, the facility could be used during normal times for System meetings and seminars. Construction of a currency storage vault would be a first step toward meeting the desire of the Conference of Presidents and the Board for a limited number of centralized currency storage points with appropriate geographic distribution.

The considerations which led the Board to the decision to change its relocation arrangements, including the safeguarding of vital equipment, were valid, and in Governor Robertson's opinion overrode the difficulties involved in prelocating a competent advisory staff. It was highly improbable that both Washington and Richmond would be the first targets, and hit simultaneously without advance warning.

For the foregoing reasons, Governor Robertson recommended: (1) that the Board and the Richmond Bank proceed with the planning of a joint relocation site, to be used during normal times as a communications and data processing center, and as a currency storage facility; (2) that the Division of Data Processing and the Richmond Bank be requested to complete studies of the feasibility and cost of operating a computer remotely along the lines set forth in Alternative No. 2 of the memorandum to the Board from Messrs. Schwartz and Steinberg dated May 15, 1964 (which alternative called for installing a main computer at the relocation site for remote use, with a satellite computer located at the Board's offices); and (3) that the Board initiate a program to train selected personnel of the Richmond Bank with respect to Board functions which would be essential in an emergency, and that they be kept currently informed concerning such operations.

After remarks by Governor Robertson in supplementation of his memorandum, Governor Mitchell commented that he was not in favor of going ahead with the arrangements, because he thought they were obsolete. His

recollection from the discussion at the meeting on May 21, 1964, was that it would be very costly to operate a computer from the relocation site.

Governor Robertson said that his understanding from computer experts was that remote operations would be more costly at the outset but not in the longer run. He cited certain long-distance computer operations that, in the opinion of an acknowledged expert, had advantages over immediate access of equipment to staff. Also, the Richmond Reserve Bank was of the view that a large computer installation by the Board at the relocation site would be better than anything the Bank could afford for installation at Richmond. To Governor Robertson, this consideration represented an important offset that greatly diminished the weight of the cost factor relating to installation of a computer at the relocation site.

Mr. Davis commented that the consideration given to installation of a computer at the relocation site rested on the presumptions, first, that the installation would be large enough to handle the needs of both the Board and the Richmond Bank, and second, that the research-oriented use of the computer in Washington would not be jeopardized. While the ultimate conclusion regarding the equipment necessary to satisfy these conditions was a matter for feasibility experts, it appeared that a larger machine might be called for than was proposed in Alternative No. 2 in the memorandum from Messrs. Schwartz and Steinberg of May 15, 1964. The equipment should be able to handle two major programs simultaneously.

In further discussion Governors Robertson and Mitchell agreed that studies by feasibility experts were essential to a decision regarding the nature of data processing equipment to be provided for the relocation center, Governor Robertson observing that the recent purchase of the 1410 system provided continuing availability of equipment for the relatively near future during which feasibility studies could be pursued.

At the conclusion of the discussion, the first of Governor Robertson's recommendations was revised to read: "That the Board and the Richmond Bank proceed with the planning of a joint relocation site, to be used during normal times as a communications and currency storage facility, and possibly as a data processing center." This recommendation, as revised, and the second and third recommendations as submitted by Governor Robertson were then approved unanimously.

Messrs. Johnson, Kelleher, Davis, Furth, Langham, Grimwood, and Steinberg then withdrew.

Testimony on coin shortage. Chairman Fascell of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations, in a letter of June 19, 1964, had invited Chairman Martin, and such representatives as he might designate, to testify regarding the coin shortage at hearings scheduled to begin on June 30.

After a discussion that focused principally on the status of certain measures that had been suggested to alleviate the coin shortage, and conversations that had been had with the Treasury Department and

with Mr. Hayes, Chairman of the Conference of Presidents, it was understood that Chairman Martin, and also one or more of the Federal Reserve Bank Presidents, would testify at the forthcoming hearings.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board memoranda recommending the following actions relating to the Board's staff:

Appointment

Margaret Allen as Charwoman, Division of Administrative Services, with basic annual salary at the rate of $3,305, effective the date of entrance upon duty.

Acceptance of resignation

Susan W. Stewart, Clerk-Stenographer, Division of Personnel Administration, effective at the close of business June 27, 1964.

Secretary

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

Item No. 1
6/23/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 23, 1964.

Mr. Charles F. Schick, President,
Central West Corp.,
Davenport, Iowa.

Dear Mr. Schick:

This refers to the request submitted through the Federal Reserve Bank of Chicago, for a determination by the Board of Governors of the Federal Reserve System as to the status of Central West Corp. as a holding company affiliate.

From the information presented, the Board understands that Central West Corp. is a holding company affiliate by reason of the fact that it owns or controls 355 (71 per cent) of the 500 outstanding shares of stock of The Dyersville National Bank, Dyersville, Iowa; and that it does not, directly or indirectly, own or control any stock of, or manage or control, any other banking institution.

In view of these facts, the Board has determined that Central West Corp. is not engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies within the meaning of section 2(c) of the Banking Act of 1933 (12 U.S.C. 221a); and, accordingly, it is not deemed to be a holding company affiliate except for the purposes of section 23A of the Federal Reserve Act and does not need a voting permit from the Board of Governors in order to vote the bank stock which it owns or controls.

If, however, the facts should at any time indicate that Central West Corp. might be deemed to be so engaged, this matter should again be submitted to the Board. The Board reserves the right to rescind this determination and make further determination of this matter at any time on the basis of the then existing facts, including additional acquisitions of bank stocks even though not constituting control.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

Item No. 2
6/23/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 23, 1964.

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

Dear Mr. Hayes:

The Board has noted without objection the action of the June 15, 1964, Conference of Presidents approving a proposed schedule of NABAC membership dues for Federal Reserve Banks and their Branches at the rate of $400 for each Head Office and $30 for each Branch. It is understood that heretofore the Federal Reserve Banks have been paying $300 per Head Office and $25 per Branch.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 3
6/23/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 23, 1964.

Mr. George T. Davies,
President,
Bankers International Corporation,
16 Wall Street,
New York 5, New York.

Dear Mr. Davies:

Reference is made to your letter of September 27, 1963, transmitted through the Federal Reserve Bank of New York, regarding the Board's letter of September 3, 1963 granting consent for Bankers International Corporation ("BIC") to purchase and hold 18,239 shares of l'Union des Mines-La Henin ("UdMLH"), Paris, France, at a cost of approximately US$1,861,000 (equivalent) subject to the following condition among others:

> "(1) That BIC shall not carry on its books the shares of UdMLH at a net amount in excess of the book capital accounts of UdMLH, after giving effect to the elimination of all known losses;"

As you suggest in the second paragraph of your letter, this provision meant that you should carry these shares on your books "at the stated book value of such shares (i.e., that portion of the 'book capital accounts' represented by the shares we own) less the corresponding portion of all known losses"; in other words, it was intended that condition numbered (1) should be read as if the words "the proportionate share of" followed "in excess of " in line 2.

You have requested that the Board rescind condition numbered (1) and permit your Corporation to carry the stock of UdMLH on your books at cost.

As you are aware, the Board's Regulation K was revised extensively effective September 1, 1963, and Section 211.8(a) contains a general consent for any Corporation to acquire and hold the shares of corporations organized under foreign law under three broad types of situations. As the Regulation does not prescribe the manner of

valuation of shares of such foreign corporations for balance sheet and examination purposes, your request has been considered in the broader context of appropriate procedure for all Section 25 and Section 25(a) Corporations.

The Board has reviewed the opinion of Price Waterhouse & Co. expressed in their letter dated September 24, 1963. The references cited in the eighth paragraph of your letter also have been reviewed. It is suggested, however, that the situations to which they relate are not comparable to Corporations organized under the provisions of Section 25(a) of the Federal Reserve Act which are "organized for the purpose of engaging in international or foreign banking or other international or foreign operations." Heretofore, the Board has taken the position that investments of a bank holding company in subsidiaries should be carried in financial statements issued to shareholders and the public at no more than the company's interest in the net assets of its subsidiaries. It is recognized, of course, that there are various differences which the investing Corporation must consider where the shares held represent merely a small minority interest.

The Board is fully mindful that the shares of UdMLH to be acquired by BIC, representing only 2-1/2 per cent of the outstanding shares of UdMLH, will have a market value in excess of the value arrived at on the basis of condition numbered (1). However, in view of the fact that the investment in shares of UdMLH represents over half of the total capital invested in BIC, a major question arises as to the appropriateness of permitting such shares to be carried at cost, as you suggest, when the value of the shares (1) on a net asset basis is very much lower than cost and (2) even on a current market basis is appreciably lower than cost.

The matter of the valuation of shares of foreign corporations for balance sheet and examination purposes is the subject of continuing observation and review and a formal determination as to uniform policy has not been made. However, in all the circumstances involved in your investment in the shares of UdMLH, the Board is not disposed to require that BIC charge off the difference between cost and (1) net asset value of the shares held or (2) current market value of the shares held. However, the Board believes that all net earnings of BIC should be set aside into a valuation reserve against the shares of UdMLH until such reserve is equal to the difference between the cost of the shares and the then current market value of the shares.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 4
6/23/64

OFFICE OF THE CHAIRMAN

June 25, 1964.

The Honorable William L. Dawson, Chairman,
Committee on Government Operations,
House of Representatives,
Washington, D. C.

Dear Mr. Chairman:

In your letter of March 3, 1964, you requested a report from the Board as to actions taken to implement the recommendations contained in the report on "Crimes Against Banking Institutions" submitted to the 88th Congress by the Committee on Government Operations.

The incidence of crimes against banking institutions (the Committee Report included savings and loan associations among banking institutions) has been and remains a matter of serious concern to the Board which, in common with other bank supervisory agencies, is interested in reducing the number of such crimes. The eight recommendations contained in the Committee Report have all been carefully considered.

The Federal Reserve System and the Federal Deposit Insurance Corporation jointly have formulated a questionnaire which is to be used in each bank examination and which should prove helpful in reducing crimes against banks. A copy of the questionnaire is enclosed. As you may know, the Federal Reserve System and the Federal Deposit Insurance Corporation jointly operate schools designed to assist in the education of assistant examiners and examiners. In both of these schools there are lectures on audit and internal controls, and in the school for examiners a lecture of four hours is devoted to discussing bank frauds. During this lecture the facts involving several actual embezzlements are presented to the students and methods of preventing such crimes analyzed. The curriculum of the schools has been expanded and now includes a lecture on external crimes against banking institutions.

The first and second recommendations suggest that Federal supervisory agencies establish, by rule or regulation, specific guidelines for the prevention of external and internal crimes against banking institutions. Such guidelines would include the requirements of adequate

audit, compulsory vacations, direct verification, decoy money, and other measures. It is questionable whether the Board has authority to issue a regulation imposing on State member banks standard requirements such as suggested by your Committee, but in any event the Board believes that better results will be obtained by the more flexible method of suggestions to management by bank examiners, based on the circumstances of the individual bank. Our examiners customarily discuss with senior management and/or directors the desirability of inaugurating practices such as those listed above, and significant improvements have been obtained in the area of internal controls and safeguards as a result of these efforts. The enclosed questionnaire was adopted to supply clearer guidelines for the examiners with respect to external crimes, in addition to guidelines previously existing with regard to internal crimes. It spells out twenty-one specific points to be checked by the examiner in appraising a bank's security and controls against external crimes. Use of this questionnaire should result in reduction of such crimes.

Recommendation number 3 suggests that examiners be trained in crime prevention so they may advise banks regarding security deficiencies. As mentioned earlier in this letter, the schools for examiners operated by the Federal Reserve and the Federal Deposit Insurance Corporation include training of this nature, and this has been expanded to cover external crimes as well as audit and internal controls and bank frauds. While our examiners cannot match the expertise of specialists in this field, they can alert bank management to security deficiencies after which expert advice on the best protective device in a given situation should be provided by the police or insurers.

Experience has indicated that most of the internal crimes committed against banks have been by trusted employees with several years' service. As these employees did not have criminal records, fingerprinting would have been of no value in detecting them. For this reason the Board doubts that fingerprinting of all directors, officers, and employees would be particularly beneficial. As a practical matter, personnel employed by small banks are usually well known to the institutions' officers, or if obtained from outside the area are usually persons of established reputations in banking or business. In the larger cities, where many employees are recruited by advertisements, personnel practices vary somewhat, but banks normally make checks of references, previous positions held, and school records. Our knowledge of the employment practices of commercial banks leads us to the conclusion that they are taking reasonable precautions to avoid employing

persons with criminal records. Such being the case, we feel little would be gained by imposing a requirement that newly employed personnel be fingerprinted, particularly since many private employers who compete with banks for personnel do not require that employees be fingerprinted. Such a requirement might make it more difficult for banks to obtain the competent personnel they need. If fingerprinting is to be required, it should be done by legislation applying to applicants for employment in industry generally, and not just to applicants for positions in banks.

The Board has not made any proposals to the other supervisory agencies looking toward establishment of an interagency committee such as contemplated by recommendation 5. While prevention of crime is, of course, a matter of concern to the System, it is not a primary responsibility of bank examiners or any other System personnel, and our contribution to such an interagency committee would be rather small unless we built up a staff devoted primarily to that purpose. The Board is reluctant to do that, because it would duplicate work being done by others, including law enforcement agencies and criminologists.

The Board does not believe that its approval of applications by State member banks should be made contingent, as suggested by recommendation 6, on a determination as to the adequacy of the bank's crime prevention facilities and procedures. In part, such a practice would probably be unauthorized. For example, as Governor Robertson testified, there is serious doubt that the Board now has authority to require internal audits; but apart from the legal question, the Board believes that better results will be obtained, as previously explained, by a more flexible approach, through suggestions by examiners to bank management. The Board does feel that it is reasonable for examiners to impress upon management the desirability of considering safety against external and internal crimes when applications are being investigated. Examiners of the System are being instructed to urge management to consider safety in any building program, and, as indicated before, to discuss inadequacies with the view of obtaining corrections.

The Committee Report notes that the directors are responsible for exercising reasonable control and supervision over a bank's affairs and for using such care and diligence in ascertaining the condition of the bank's business as would be exercised by an ordinarily prudent and diligent man. The Board agrees with this statement. At the conclusion of each examination, System examiners customarily meet with either the top executive officers, who are also usually directors, or with the Board of Directors as a whole. During such meeting any inadequacies noted during the course of examination are discussed with the directors and/or senior management. Moreover, a copy of the examination report

is always made available to bank directors, and they are urged to review the report carefully with the view of effecting corrections. Our examiners have long informed directors of their responsibility and liability and urged them to take any steps appropriate to correct deficiencies as you suggest in recommendation number 7.

Although the objectives of recommendation number 8 are desirable, the Board would not favor enacting legislation that would permit supervisors to approve or disapprove major changes in the management arising from changes in control or ownership. Such legislation would be exceedingly difficult, if not impossible, to administer. It is unclear what grounds could be used by supervisory authorities to deny a person permission to purchase stock unless that person had a criminal record or perhaps something such as a history of bankruptcies.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. Mc. Martin, Jr.

Enclosure.

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

Item No. 5
6/23/64
S-1918

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 30, 1964

Dear Sir:

Enclosed are two copies of revised page 16 of the report of examination, Form F. R. 410, which the Board has approved for use effective upon receipt. A supply of the new pages sufficient to provide for examinations during the next several months is being forwarded to the Vice President in Charge of Examinations. Additional copies may be obtained upon request.

As an aid in implementing some of the recommendations contained in the 18th report by the Committee on Government Operations on "Crimes Against Banking Institutions," the enclosed questionnaire entitled "Security and Controls Against External Crimes" has been devised. This questionnaire is to be used in the examination of each bank.

The Board feels that examiners should, when appropriate, discuss with management other recommendations of the Committee. In some cases examiners may feel it desirable to discuss with management the fingerprinting of employees, particularly in those instances where their jobs permit or require access to negotiable securities. In applications requiring the Board's approval, examiners should alert management to security weaknesses in an institution's crime prevention facilities, and in those instances where building programs are contemplated, management should be urged to consider the safety factor as well as other factors. Examiners will, of course, continue to impress upon directors their responsibility for the adequate security of their institutions against losses from crimes.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosures

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS