

Minutes for September 21, 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.

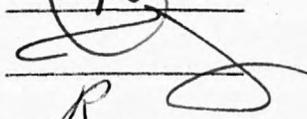
It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

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.

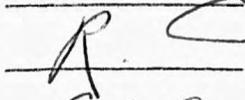
Chm. Martin



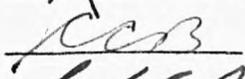
Gov. Mills



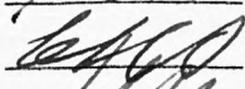
Gov. Robertson



Gov. Balderston



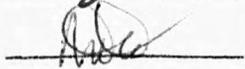
Gov. Shepardson



Gov. Mitchell



Gov. Daane



Minutes of the Board of Governors of the Federal Reserve System on Monday, September 21, 1964. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Robertson
Mr. Daane

Mr. Sherman, Secretary
Mr. Young, Adviser to the Board and Director,
Division of International Finance
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Solomon, Director, Division of
Examinations
Mr. Davis, Acting Director, Division of
Data Processing
Mr. Hexter, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Daniels, Assistant Director, Division
of Bank Operations
Mr. Leavitt, Assistant Director, Division of
Examinations
Mr. Bass, Assistant Controller
Mr. Langham, Assistant Director, Division
of Data Processing
Mrs. Semia, Technical Assistant, Office
of the Secretary

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

	<u>Item No.</u>
Letter to Harbor National Bank of Boston, Boston, Massachusetts, granting its request for permission to maintain reduced reserves.	1
Letter to The Merchants and Farmers State Bank of Weatherford, Weatherford, Texas, granting its request for permission to exercise fiduciary powers.	2

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Item No.

Letter to the Federal Reserve Bank of Richmond approving the exercise of an option to purchase certain property for a relocation site for joint use by the Board and the Bank.

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Messrs. Hooff, Bass, and Langham then withdrew from the meeting.

"Divestment" plan of Mercantile Trust (Item No. 4). In June 1963 the Board learned that Mercantile Trust Company, St. Louis, Missouri, intended to have a wholly-owned subsidiary corporation buy the assets and business of a large mortgage company and the stock of certain other corporations. On June 20, 1963, the Board informed the bank that applicable Federal statutes (in particular, section 5136 of the Revised Statutes) prohibit purchase of corporate stock by subsidiaries of a member bank as well as by the member bank itself. Despite this, the member bank took the position that circumstances beyond its control made it mandatory that the acquisitions take place, and the transactions were consummated on June 21. However, the bank informed the Board, in letters of June 19 and 21 and August 9, 1963, that it would, within a reasonable period of time and in an orderly manner, either dispose of the stocks by way of sale or dissolve its then wholly-owned subsidiaries. The Board was subsequently informed that the assets of three of the corporations in question had been sold and the corporations were being dissolved. The stocks of four corporations remained, and there had now been distributed a memorandum dated September 17, 1964, from the Legal Division relating to the Bank's proposal with respect to them.

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Mercantile Trust proposed to execute a trust indenture with five individual trustees, who had not been identified. The indenture would permit the directors of Mercantile to remove the trustees without cause and to elect substitute trustees. Officers and directors of Mercantile Trust would be eligible to be trustees. The trustees would be required to report annually to Mercantile Trust. When the initial transactions had taken place, the member bank would have \$209,000 less cash, its subsidiary would have \$208,000 more cash, and the trustees would hold the corporate stocks through a newly-created intermediary corporation. The beneficiaries of the trust would be the stockholders of Mercantile, and net income derived from the trust would be distributed among them, pro rata. The trustees would have absolute discretion with respect to the manner of distributing net income, and broad discretion with respect to selling or otherwise disposing of the trust estate. Upon termination of the trust, its assets would be distributed to Mercantile's stockholders. The trust could be terminated by Mercantile at any time and for any reason, and various other means of termination were provided.

The memorandum reviewed various considerations bearing on the question whether or not the plan would effect a satisfactory disposition of the stocks. In comments on prior rulings of the Board and the Comptroller of the Currency in comparable situations, it was pointed out that on some occasions transfers to trustees for the benefit of a bank's

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shareholders may have achieved an effective separation of the stock from the control or influence of the bank, for example, where the trustees were responsible individuals not connected with the bank, and the bank retained no power to remove or appoint trustees, to modify the terms of the trust, or otherwise to influence its operation. However, in most instances, probably, the trustees had been persons intimately connected with the bank and, viewed realistically, it was clear that the bank's control of the stock would be diminished only slightly, if at all, by the purported divestment. Nevertheless, such arrangements had been accepted by both the Board and the Comptroller, either expressly or tacitly. A relatively recent example arose out of the purchase of the stock of an insurance company by Continental Bank and Trust Company of Salt Lake City, Utah, in violation of section 5136. In 1961 the Board requested that member bank to take appropriate steps to divest itself of all interest in the stock, stating that such divestment would be accomplished if the stock was made subject to a trust under which dividends would be paid to the bank's shareholders and the trustees would hold the stock solely for the benefit of shareholders. The Board took the position that such an arrangement was satisfactory even though the trustees actually were persons closely associated with the bank and the bank had practically complete control over the trust situation by virtue of its power to modify the terms of the trust in almost all respects.

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In conclusion, the Legal Division expressed the view that, Mercantile Trust having violated Federal law by purchasing corporate stocks, action to correct the violation should be substantive, and not mere formal steps without real significance. The plan embodied in the proposed trust indenture would leave Mercantile Trust in control of the stock and would simply deprive depositors of the protection afforded by a corresponding portion of the bank's capital structure. Accordingly, and despite prior supervisory acquiescence in similar arrangements, the Legal Division recommended that Mercantile Trust be informed that its proposed arrangement would not be satisfactory, but that the stocks in question should be either sold to outside interests or, if that was not feasible, placed in a trust that was neither under the control of the bank nor operated in close conjunction with its activities. Attached to the memorandum was a draft of letter to the member bank that would take that position.

Mr. Hexter, in the course of summary comments at the Board's invitation, observed that the proposal of Mercantile Trust appeared to be merely a means of nullifying the Congressional prohibition against acquisition of corporate stocks by member banks. If the plan was approved, a member bank could violate that prohibition, and then continue to enjoy the fruits of the violation by the device of establishing a trust over which it retained control. Despite the precedent of the Salt Lake City case, and others in which the Comptroller of the Currency had permitted trusts under the domination of national banks to be used

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in somewhat similar circumstances, the Legal Division believed that the only effective way to carry out the statutory purpose was to insist on a satisfactory divestment.

Mr. Hackley stated his agreement with the Legal Division's conclusion, but added that he was a little concerned about its apparent inconsistency with the Salt Lake City situation. It would be well to recognize that if Mercantile Trust should contest by litigation a decision by the Board reflecting the Legal Division's recommendation, it was impossible to predict how a court might look at the matter. Technical arguments might be made by Mercantile Trust that, by acting through a wholly-owned subsidiary, it had not purchased the corporate stocks for its own account, even though the effect was the same as if it had.

Governor Daane inquired if there had been any indication as to the legal defense Mercantile Trust was likely to make of its present position. Mr. Hexter replied that counsel for the member bank, when the package of transactions was still in prospect last year, had taken the position that the purchases of corporate stock through a wholly-owned subsidiary would not violate either State or Federal law. Although the submission to the Board of the trust indenture had not been accompanied by supporting legal opinion as to the merits of the plan as a satisfactory divestment, it could be assumed that the member bank's lawyers had participated in drafting the indenture. Mr. Hexter continued

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with comments on earlier instances of acquisitions of corporate stock by Mercantile Trust, which had been exceptionally active in such transactions.

In response to an inquiry by Chairman Martin, Mr. Hexter indicated that the Board's recourse, if Mercantile Trust disregarded a rejection of its proposal, would be to consider whether the situation warranted proceedings for termination of membership or removal of directors or officers.

After further discussion during which certain changes in wording were agreed upon, the letter to Mercantile Trust was approved unanimously in the form attached as Item No. 4.

Legal sanctions. Governor Balderston referred to the sanctions mentioned during the preceding discussion, namely, proceedings for termination of membership or removal of directors or officers, and commented on the desirability that the Board have access to better enforcement measures. The Mercantile Trust matter presented one more situation in which the Board was expected to enforce the law without means of doing so except by resort to extreme measures. In response, Mr. Hackley pointed out that the program of legislation discussed by the Board in June of this year had included a suggestion that the Board might request power of injunction, which would have provided another alternative for action in circumstances such as might be involved in the situation just discussed.

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Political candidacy of Chairman Briggs. Chairman Martin stated that Robert P. Briggs, Chairman of the Federal Reserve Bank of Chicago, had reported that he had accepted the Republican nomination for office on the Michigan State Board of Education. The office could be attained only through a partisan political campaign. Chairman Martin added that Mr. Briggs had indicated he would tender his resignation as Chairman of the Chicago Reserve Bank, on the ground that the partisan political campaign would be inconsistent with the position taken by the Board in its 1915 resolution against the holding of political office by Reserve Bank directors and others.

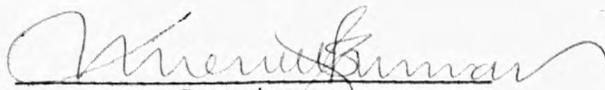
After discussion, it was agreed that Chairman Martin would inform Mr. Briggs that, in view of the political nature of his candidacy for the office, he should resign as Chairman and as a director of the Federal Reserve Bank of Chicago.

The meeting then adjourned.

Secretary's Note: Acting in the absence of Governor Shepardson, Governor Robertson today approved on behalf of the Board the following items:

No. 5) Letter to the Federal Reserve Bank of St. Louis (attached Item) regarding the indebtedness to a national bank of an assistant examiner as a result of the conversion of the State nonmember bank at which the loan originated.

No. 6) Letter to the Federal Reserve Bank of San Francisco (attached Item) approving the appointment of Wilbert M. Nylander as assistant examiner.


Secretary



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

3216
Item No. 1
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 21, 1964

Board of Directors,
Harbor National Bank of Boston,
Boston, Massachusetts.

Gentlemen:

With reference to your request submitted through the Federal Reserve Bank of Boston, the Board of Governors, acting under the provisions of Section 19 of the Federal Reserve Act, grants permission to the Harbor National Bank of Boston to maintain the same reserves against deposits as are required to be maintained by nonreserve city banks, effective as of the date it opens for business.

Your attention is called to the fact that such permission is subject to revocation by the Board of Governors.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 2
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 21, 1964



Board of Directors,
The Merchants and Farmers State Bank of Weatherford,
Weatherford, Texas.

Gentlemen:

This refers to your request for permission, under applicable provisions of your condition of membership numbered 1, to exercise fiduciary powers.

Following consideration of the information submitted, the Board of Governors of the Federal Reserve System grants permission to The Merchants and Farmers State Bank of Weatherford to exercise any and all fiduciary powers now or hereafter conferred upon such bank by or pursuant to the laws of the State of Texas.

While the Board notes that the present capital position of the bank is considerably lower than desirable, permission is granted for the exercise of fiduciary powers in view of the expected small volume of trust business involved and convenience afforded the bank's customers. The addition of capital funds in 1963 was beneficial, but further strengthening of capital structure is believed necessary to enable the bank satisfactorily to serve the needs of the Weatherford area. The Board is informed that the fairly recent sale of stock as well as local economic conditions make this an unfavorable time to market additional common capital. However, the directors are urged to improve capital adequacy through continued retention of earnings and also to sell additional stock at the earliest favorable time should a need then exist.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 3
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 21, 1964

CONFIDENTIAL (FR)

Mr. Edward A. Wayne, President,
Federal Reserve Bank of Richmond,
Richmond, Virginia. 23213

Dear Mr. Wayne:

The Board approves exercising the option to purchase the property described in your letter of September 10, 1964, at the option price of \$15,949.

It is understood that your Bank will ask the Richmond architectural firm of Marcellus Wright & Son, after consultation with Board and Bank representatives, to prepare preliminary plans for the construction of a relocation facility for joint use by the Board and your Bank.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 4
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 21, 1964.



Mr. John Fox, President,
Mercantile Trust Company,
St. Louis 66, Missouri.

Dear Mr. Fox:

In its letter of June 20, 1963, the Board of Governors informed your bank that the acquisition, by the bank's subsidiary, of the stock of certain corporations, in connection with the acquisition of the assets and business of Mercantile Mortgage Company, would violate section 9 of the Federal Reserve Act and section 5136 of the United States Revised Statutes. In a letter dated June 21, 1963, Mr. Cravens stated that the subsidiary intended "within a reasonable period of time and in an orderly manner either to dispose of these stocks by way of sale or to dissolve its then wholly owned subsidiaries."

In a letter of October 31, 1963, you informed the Board that three of the corporations involved were being dissolved and you outlined a plan under which the stock of four of the remaining corporations would be sold to a new corporation whose shares would be held by trustees. With a letter dated November 15, 1963, you enclosed copies of a draft of a Trust Indenture designed to effectuate that plan.

When an acquisition of corporate stock has occurred in violation of Federal law, it is the obligation of the member bank to undo the transaction to the extent practicable, and not to continue, in effect, a situation that the statutory prohibition was designed to prevent. This could be accomplished by the stock being divorced from the bank's ownership and control either through sale of the stock or through dissolution of the corporations, and these were the alternatives contemplated by your bank at the time of Mr. Cravens' letter of June 21, 1963. However, your bank apparently decided thereafter that the interests of its shareholders might be better served if the stocks were turned over to trustees for the benefit of those shareholders. In the judgment of the Board of Governors, an adequate divestment by that means would constitute a satisfactory adjustment of the situation.

Mr. John Fox

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The arrangement embodied in the draft Trust Indenture, however, includes provisions that prevent the arrangement from effecting a satisfactory divestment of the stocks from the control of Mercantile Trust Company. That draft expressly provides that the five trustees could be officers or directors of Mercantile (§ 2.1). The directors of Mercantile would be empowered to remove any or all of the trustees "without cause" (§ 2.3). Whenever a vacancy occurred among the trustees (including vacancies resulting from removal of trustees pursuant to § 2.3), the directors of Mercantile Trust would be authorized to fill the vacancies (§ 2.4). The trustees would report annually to the President of Mercantile Trust (§ 2.9). The net income from the trust estate would be distributable among the shareholders of Mercantile Trust (§ 4.1), the trustees having authority to make distributions "in whatsoever manner" they might select, "it being the intention hereof that Trustees have absolute discretion with respect to the manner of distributing net income" (§ 4.2). The trust could be terminated at any time by the directors of Mercantile Trust (§ 5.2).

Although the draft Trust Indenture includes a number of other provisions that may be relevant, those summarized in the preceding paragraph reflect the general nature of those aspects of the plan that are significant for this purpose. In the circumstances, it is the obligation of Mercantile Trust Company to divest itself of both indirect ownership and control of the corporate stocks, which were acquired in contravention of the statutory prohibition. Under the proposed Trust Indenture, however, although the bank's indirect ownership of those stocks would be terminated, the stocks would be held by trustees (the majority of whom could be directors, officers, or employees of the bank) who would report to the bank and serve at the will of the bank, being removable "without cause" at any time by the bank's directors, who would then be authorized to designate their successors.

For these reasons, the Board is compelled to conclude that the proposal presented would not effect a satisfactory divestment of these corporate stocks. The opposite conclusion would enable member banks to circumvent the statutory prohibition against stock purchases by acquiring corporate stocks and then placing legal title thereto in trustees who were subject to effective control by the member bank.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

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Item No. 5
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 21, 1964

Mr. O. O. Wyrick, Vice President,
Federal Reserve Bank of St. Louis,
St. Louis, Missouri 63166.

Dear Mr. Wyrick:

In your letter of September 16, 1964, you advised that Mr. William F. Denton, an Assistant Examiner for the Federal Reserve Bank of St. Louis, was now indebted to a national bank. This indebtedness resulted from the conversion to a national bank by a State nonmember bank to which Mr. Denton was indebted.

Since this loan originated at a nonmember bank, the Board concurs in your view that no objection should be interposed to the continuance of the loan so long as it is liquidated in accordance with its terms. Your attention is called to the fact that renewal of this loan would be considered as the making of a new loan by the national bank and apparently would be prohibited by the Criminal Code as discussed in the Board's letter S-1680 of November 20, 1958.

In the remote possibility that an examination of the national bank were to be made by Federal Reserve Bank examiners, Mr. Denton should not participate in such examination if his indebtedness to that bank remained unpaid.

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. 6
9/21/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 22, 1964

Mr. E. H. Galvin, Vice President,
Federal Reserve Bank of San Francisco,
San Francisco, California. 94120

Dear Mr. Galvin:

In accordance with the request contained
in Mr. Cavan's letter of September 16, 1964, the
Board approves the appointment of Wilbert M. Nylander
as an assistant examiner for the Federal Reserve
Bank of San Francisco, effective today.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.