FR609

Minutes for October 1, 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 Thursday, October 1, 1964. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Noyes, Adviser to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Shay, Assistant General Counsel
Mr. Spencer, General Assistant, Office of the Secretary
Miss Hart, Senior Attorney, Legal Division
Mr. Young, Senior Attorney, Legal Division
Mr. Robinson, Attorney, Legal Division

Presidential reorganization plan (Item No. 1). There had been distributed a memorandum dated September 29, 1964, from the Legal Division with regard to a letter from the Bureau of the Budget that invited the Board to recommend any Presidential reorganization plan that the Board might consider desirable, in connection with the Bureau's review of proposals to improve the organization and management of agencies and functions that might be effectuated under the Reorganization Act of 1949, as amended.

The memorandum pointed out that the request of the Bureau was identical with one made on November 6, 1961, in response to which the Board by letter of December 18, 1961, stated that it had no recommendations

to make and that it would be preferable to make any desirable changes pursuant to specific legislation by Congress rather than under a reorganization plan. A draft of reply to the Budget Bureau similar to the Board response of December 18, 1961, was attached to the Legal Division's memorandum.

During discussion, Governor Robertson suggested omitting the concluding sentence of the draft letter, which read: "If it should develop that changes of a related nature might appear to be desirable, the Board believes that it would be preferable that they be accomplished pursuant to specific legislation by Congress rather than under a reorganization plan."

Governor Mills expressed some reservation about deleting this sentence. In his view, the independence of the Federal Reserve might be involved. It was conceivable that if the Board was included in a Presidential reorganization plan, rather than having any changes that might be desirable accomplished through legislation, the independent relationship of the System with the Executive Branch might be altered.

Governor Mitchell stated that he favored omitting the concluding sentence of the draft letter. He suggested, however, that the Board might wish to present a proposal that would make clear that the Board had statutory authority to delegate certain functions.

The discussion that followed centered on the suggestion made by Governor Mitchell, during which it was noted that the Board had not yet

arrived at specific recommendations that could be made with respect to the delegation of authority. Therefore, it seemed desirable not to refer to a proposal of that nature at this juncture.

At the conclusion of discussion, it was understood that the letter to the Bureau of the Budget would be sent in the form drafted with the concluding sentence omitted, Governor Mills' reservations having been noted. A copy of the letter, as sent, is attached as Item No. 1.

Messrs. Noyes, Brill, and Young then withdrew from the meeting.

Proposed amendments to Regulation R (Items 2 and 3). There had been distributed a memorandum dated September 29, 1964, from the Legal Division with regard to two separate requests that Regulation R, Relationships with Dealers in Securities under Section 32 of the Banking Act of 1933, be amended to permit interlocking service in specified situations between member banks and securities companies.

The memorandum stated that one request, expressed in a letter of June 1, 1964, from the law firm of Sullivan & Cromwell, New York, New York, to Mr. Emil J. Pattberg, Jr., of The First Boston Corporation, proposed that Regulation R be amended to permit directors of underwriting firms to serve as directors (but not officers or employees) of member banks, possibly in a limited number or as a limited percentage of the banks' boards. The letter containing this proposal had been left by Mr. Pattberg with Chairman Martin on July 29, 1964.

The other request, the memorandum indicated, was the outcome of extended correspondence with Mr. Morton N. Stein of Stein & Hoffman,

Bayonne, New Jersey, dealers in stocks, bonds, and mutual funds. Mr. Stein proposed that Regulation R be amended to permit registered representatives of member firms of the National Association of Securities Dealers to serve at the same time as employees (but not officers or directors) of member banks. He suggested that such employment be permitted only if the individual concerned signed a statement conditioning the interlocking service on an agreement to confine activities in selling securities exclusively to areas outside the bank; not to use "privileged" information gained from bank employment; and not to refer to the bank in the course of selling activities.

The Legal Division's memorandum cited certain proposals for liberalizing amendments to the Regulation that had been considered by the Board in the past and then went on to summarize arguments in favor of the amendments now proposed. It was noted that the Federal Reserve Bank of New York, in commenting on the proposals, had concluded that such arguments did not have enough merit to justify the Board in making the requested amendments and that the proposals should be addressed to Congress, rather than to the Board, as possible reasons for liberalizing the statute. The Legal Division had reached a similar conclusion. Drafts of letters to Mr. Pattberg and Mr. Stein that would deny their requests on the ground that the proposed amendments did not appear to lie within the scope of authority granted the Board by section 32, and indicating that the proposals would require legislative action, were attached.

During the ensuing discussion, the members of the Board indicated their general concurrence in the line of reasoning presented in the Legal Division's memorandum. There also was agreement with a change of wording suggested by Chairman Martin in the draft letters.

The letters to Messrs. Pattberg and Stein were then approved unanimously in the form attached as Items 2 and 3, respectively.

Messrs. Shay and Robinson then withdrew from the meeting, as did Miss Hart.

Uniform accounting procedures. Governor Robertson reported for the information of the Board that following the meeting of the Federal Advisory Council on September 22, 1964, he had discussed with several members of the Council what might be done to spur the banking community toward the development of uniform accounting procedures for banks.

Governor Robertson went on to say that the need for the development of uniform standards also had been discussed with representatives of the American Bankers Association, who had expressed their willingness to lend support to the project. In this connection, they proposed to form a committee of persons especially knowledgeable in the field to work with the Federal supervisory agencies. The committee would serve in an advisory capacity and would express views on what should be uniform standards. In the meantime, the Federal Reserve could be developing uniform accounting principles thought to be appropriate and these could be compared and melled with whatever suggestions the committee might have.

Governor Robertson also stated that the Board could expect to receive a request for extension of the October 21, 1964, deadline for the

receipt of comments on the Board's proposed new Regulation F (Securities of Member State Banks) and the proposed form to be used in connection with the registration of bank securities.

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:

Transfer

Mary Ellen Miller, from the position of Stenographer in the Division of Personnel Administration to the position of Stenographer in the Division of Examinations, with no change in basic annual salary at the rate of $4,005, effective October 5, 1964.

Salary increase

Arthur F. Le Vasseur, Clerk, Division of Administrative Services, from $3,805 to $4,140 per annum, with a change in title to Composition Clerk, effective October 11, 1964.

Acceptance of resignations

Diane Quade, Secretary, Office of the Secretary, effective at the close of business September 29, 1964.

Karen M. Cava, Secretary, Division of Data Processing, effective at the close of business October 2, 1964.

Secretary

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 1
10/1/64

OFFICE OF THE CHAIRMAN

October 1, 1964.

Honorable Elmer B. Staats,
Acting Director,
Executive Office of the President,
Bureau of the Budget,
Washington, D. C. 20503

Dear Mr. Staats:

This is in response to your letter of July 27, 1964, in which you invite the Board to recommend to the Bureau any Presidential reorganization plan action which the Board may consider desirable in connection with the Bureau's review of proposals concerning the organization and management of agencies and functions for possible presentation during the next session of Congress under the Reorganization Act of 1949, as amended.

The Board has no such recommendations to make at this time.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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

Item No. 2
10/1/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 1, 1964.

Mr. Emil J. Pattberg, Jr.,
President and Chairman of the Board,
The First Boston Corporation,
20 Exchange Place,
New York, New York.

Dear Mr. Pattberg:

This refers to the letter of June 1, 1964, to you from the law firm of Sullivan & Cromwell, a copy of which you left with Chairman Martin when you and Mr. Overby visted here on July 29, 1964, suggesting that the Board's Regulation R (12 CFR 218) might be amended to permit directors of underwriting corporations to serve at the same time as directors (but not officers or employees) of member banks, possibly in a limited number or as a limited percentage of the banks' boards.

Section 32 of the Banking Act of 1933, as amended, the statute under which the Board has issued its Regulation R, reads as follows:

> "No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or similar securities, shall serve at the same time as an officer, director, or employee of any member bank . . .".

The statute provides for exceptions only

> ". . . in limited classes of cases in which the Board . . . may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

A primary objective of the Banking Act of 1933, of which section 32 was an integral part, was to divorce commercial banking from investment banking. The Senate Committee in reporting on the bill that

became the Act was of the view that one of the chief causes of the financial difficulties of the late 1920's and early 1930's was the participation by commercial banks in the issuance and sale of securities. (Sen. Rep. No. 77, 73 Cong., 1st Sess. 1933) The policy judgment which led to the divorcement principle was summarized by Senator Bulkley, one of the sponsors of the Act, when he said

> ". . . the banker who has nothing to sell to his depositor is much better qualified to advise disinterestedly and to regard diligently the safety of depositors . . .". (75 Cong. Rec. 9912 (1932))

Accordingly, and in addition to other provisions of the Act designed to separate commercial and investment banking, section 21 of the Act forbids underwriting firms to engage in commercial banking, and section 20 prohibits member banks from being affiliated with such firms. To forestall the possibility of undesirable influences that might arise from interlocking services, Congress added section 32.

From the beginning, the Board has recognized that section 32 might cause hardship in individual cases involving men of the highest probity, where the likelihood was negligible that any improper influence would be exerted. But, as the Supreme Court stated in Board of Governors v. Agnew, 329 U. S. 441, 449 (1947), the section "is a preventive or prophylactic measure. The fact that respondents have been scrupulous in their relationships to the bank is therefore immaterial". Since 1935, the Board has not had authority to issue permits exempting individuals from the prohibition of the section. And, although the question has been presented to it a number of times, and carefully considered, the Board--aside from the single exemption now in Regulation R--has not found it possible to frame an amendment to the regulation applying to "limited classes of cases" which would permit certain interlocking relationships that were squarely within the prohibition of the statute and at the same time adequately safeguard the purpose of the Congress in enacting the law. The Board does not believe that an amendment to the regulation along the lines suggested in the letter of Sullivan & Cromwell would satisfactorily meet this test.

The argument has been made on previous occasions, as well as in Sullivan & Cromwell's letter, that when Congress permitted interlocking service under other statutes, such as the Investment Company Act of 1940, it implicitly concluded that no harm would result if a limited number of directors of underwriting firms were to serve as directors of member banks. However, the Investment Company Act of 1940 was directed primarily at protecting shareholders in investment companies, while the Banking Act of 1933 had as a main purpose the protection of depositors in commercial banks. Moreover, it would seem more consistent with the

legislative scheme to conclude that when Congress did not amend section 32 in 1940, or in connection with other similar subsequent legislation, it reaffirmed, in effect, its earlier decision as reflected in section 32.

Sullivan & Cromwell also urged in their letter that it is no longer necessary for interlocking directorates between member banks and underwriting firms to be forbidden. However, even assuming this to be true, the argument is one that should be addressed to the Congress, rather than the Board. The Board appreciates your interest in the matter, but it does not believe it should endeavor to amend Regulation R in a way that might ultimately nullify an important part of the legislative purpose in enacting the statute.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 3
10/1/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 1, 1964.

Mr. Morton N. Stein,
Stein & Hoffman,
1137 Avenue C,
Bayonne, New Jersey.

Dear Mr. Stein:

This refers to your letter of August 5, 1964, in which you asked that the Board amend Regulation R to permit registered representatives of member firms of the National Association of Securities Dealers to serve at the same time as employees (but not officers or directors) of member banks. You suggested that such employment be permitted only if the individual concerned signs a statement conditioning the interlocking service on an agreement that he will confine his activities in selling securities exclusively to areas outside the bank, will not use "privileged" information gained from his bank employment, and will not refer to the bank in the course of his selling activities. You also suggested that the Board "have the power to fine or suspend individuals violating this regulation". The situation that gave rise to your proposal has been the subject of previous correspondence with you.

Section 32 of the Banking Act of 1933, as amended, the statute under which the Board has issued its Regulation R, reads as follows:

> "No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or similar securities, shall serve at the same time as an officer, director, or employee of any member bank . . ."

The statute provides for exceptions only

> ". . . in limited classes of cases in which the Board . . . may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

A primary objective of the Banking Act of 1933, of which section 32 was an integral part, was to divorce commercial banking from the business of selling, underwriting, and dealing in securities. The Senate Committee in reporting on the bill that became the Act was of the view that one of the chief causes of the financial difficulties of the late 1920's and early 1930's was the participation by commercial banks in the issuance and sale of securities. (Sen. Rep. No. 77, 73 Cong., 1st Sess. 1933) The policy judgment which led to the divorcement principle was summarized by Senator Bulkley, one of the sponsors of the Act, when he said

> ". . . the banker who has nothing to sell to his depositor is much better qualified to advise disinterestedly and to regard diligently the safety of depositors . . .". (75 Cong. Rec. 9912 (1932))

Accordingly, and in addition to other provisions of the Act designed to separate commercial and investment banking, section 21 of the Act forbids securities firms to engage in commercial banking, and section 20 prohibits member banks from being affiliated with such firms. To forestall the possibility of undesirable influences that might arise from interlocking services, Congress added section 32.

From the beginning, the Board has recognized that section 32 might cause hardship in individual cases involving men of the highest probity, where the likelihood was negligible that any improper influence would be exerted. But, as the Supreme Court stated in Board of Governors v. Agnew, 329 U. S. 441, 449 (1947), the section "is a preventive or prophylactic measure. The fact that respondents have been scrupulous in their relationships to the bank is therefore immaterial". Since 1935, the Board has not had authority to issue permits exempting individuals from the prohibition of the section. And, although the question has been presented to it a number of times, and carefully considered, the Board--aside from the single exception now in Regulation R--has not found it possible to frame an amendment to the regulation applying to "limited classes of cases" which would permit certain interlocking relationships that were squarely within the prohibition of the statute and at the same time adequately safeguard the purpose of the Congress in enacting the law. It is to be noted that, while interlocking relationships involving employees of

member banks or securities firms were not included in the prohibition of section 32 as it was originally enacted, such relationships were specifically added by an amendment to the statute in 1935.

On the basis of the foregoing, the Board does not believe that an amendment to the regulation that would permit interlocking employee relationships as suggested in your proposal would conform to the policy expressed by section 32, as amended, or to the purposes of the statute as stated by the Supreme Court in the decision cited above.

If the hardships described in your letter outweigh the public policy expressed in section 32, then this would be an argument in support of an amendment to the law which should be addressed to the Congress, rather than to the Board. While the Board appreciates your interest in the matter, it does not believe it should endeavor to amend Regulation R in a way that might ultimately nullify an important part of the legislative purpose in enacting the statute.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.