



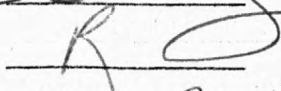
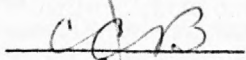
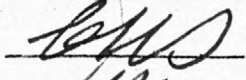

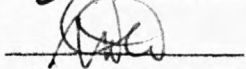
Minutes for October 15, 1964.

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 15, 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. Daane

Mr. Sherman, Secretary
 Mr. Bakke, Assistant Secretary
 Mr. Young, Adviser to the Board and Director,
 Division of International Finance
 Mr. Molony, Assistant to the Board
 Mr. Cardon, Legislative Counsel
 Mr. Hackley, General Counsel
 Mr. Brill, Director, Division of Research and
 Statistics
 Mr. Solomon, Director, Division of Examinations
 Mr. Hooff, Assistant General Counsel
 Mr. Dembitz, Associate Adviser, Division of
 Research and Statistics
 Mr. Sammons, Adviser, Division of International
 Finance
 Mr. Leavitt, Assistant Director, Division of
 Examinations
 Mrs. Semia, Technical Assistant, Office of the
 Secretary
 Miss Hart, Senior Attorney, Legal Division
 Mr. Via, Senior Attorney, Legal Division

Application of State Bank of Albany (Items 1, 2, and 3). There
 had been distributed drafts of an order and statement reflecting the
 Board's approval on October 6, 1964, of the application of State Bank
 of Albany, Albany, New York, to merge with The First National Bank of
 Cairo, Cairo, New York.

After a discussion during which a change was agreed upon in the
 language of the statement, the issuance of the order and statement was

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authorized. Copies of the documents, as issued, are attached as Items 1 and 2. A dissenting statement issued by Governor Robertson is attached as Item No. 3.

Miss Hart and Mr. Via then withdrew from the meeting.

Foreign travel (Item No. 4). There had been distributed a memorandum dated October 13, 1964, from Mr. Young recommending foreign travel, described in the memorandum (attached as Item No. 4), by Messrs. Hersey, Adviser, and Reynolds, Associate Adviser, of the Division of International Finance.

After discussion the recommendation was approved unanimously. The Board also authorized Mr. Young to undertake foreign travel in connection with his attendance at the November meeting of the Bank for International Settlements in Basle, Switzerland.

Mr. Sammons then withdrew from the meeting.

Proposed revision of Regulation Q (Items 5, 6, and 7). On May 12, 1964, the Board considered various recommendations of the Legal Division, contained in a distributed memorandum of April 23, 1964, looking toward a revision of Regulation Q, Payment of Interest on Deposits. Pursuant to that discussion, a draft of a possible revision of the regulation, dated May 20, 1964, was sent to the Federal Reserve Banks for comment. A summary of the Reserve Banks' views was distributed with a memorandum of July 24.

A distributed memorandum dated August 14, 1964, from the Legal Division submitted for the Board's consideration a new draft, revised

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in the light of comments from the Reserve Banks. The Division recommended that, subject to any further changes the Board might wish, the new draft be submitted for comment to the Federal Deposit Insurance Corporation and the Comptroller of the Currency, with an explanatory memorandum and a document showing textual changes; that the new draft also be sent to the Reserve Banks for their information and any further comments they might wish to make; and that, following receipt of comments and further consideration by the Board, the proposed revision then be published in the Federal Register for comment by the public. Conforming changes would be necessary in Regulation D, Reserves of Member Banks. At its meeting on May 12, 1964, the Board had indicated willingness to approve an amendment to the Supplement to Regulation Q to provide a single maximum rate of interest for savings deposits, in lieu of the present split rate based upon the length of time the funds are on deposit. The Legal Division now recommended that, after consultation with the Federal Deposit Insurance Corporation and agreement by the Corporation to take similar action with respect to its parallel regulation, this change be adopted to become effective upon publication in the Federal Register. It was noted that on such rate actions the Board had never requested public comment or given advance notice.

The August 14 memorandum continued with a discussion of the principal questions that had been raised by comments of the Reserve Banks, and the way in which consideration of those questions had been reflected in the new draft. The substance of these points was as follows:

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In the definition of savings deposits, the reference to organizations "not operated for profit" was changed to organizations "no part of the net earnings of which inures to the benefit of any private shareholder or individual."

The new draft, like the previous draft and the present regulation, would exclude deposits of business corporations from the definition of a savings deposit.

Pursuant to a recommendation by the Legal Division, the new draft did not specify an amount limitation on savings deposits of nonprofit organizations and trustees in bankruptcy, whereas the May 20 draft had specified a limitation of \$25,000. (Several subordinate recommendations here followed, for consideration in the event the Board preferred to retain an amount limitation.)

The Legal Division continued to believe that a prohibition of savings deposits with fixed maturities would avoid administrative problems, accord with the intent of the statute, and have no real adverse effect on depositors.

Savings deposits were limited to deposits as to which the depositor "may at any time be required" to give not less than 30 days' written notice of withdrawal.

The new draft omitted a provision in the May 20 draft to the effect that premiums given for advertising purposes shall not be regarded as a payment of interest if they have a value of not more than \$5 and are not

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given more often than once in any period of 18 months; it was now considered preferable to cover this matter by published rulings. Likewise, it would seem desirable not to attempt to incorporate any provision regarding the absorption of the costs of banking services.

Although the Legal Division shared expressed hopes that the long-standing question whether absorption of exchange charges constitutes a payment of interest might be settled by a specific provision in Regulation Q, solution of that question continued to depend upon the achievement of agreement with the Federal Deposit Insurance Corporation, and the Division felt that the issuance of a revised regulation should not be delayed awaiting that agreement.

The new draft included a paraphrase of the statutory prohibition of payment of interest on demand deposits.

Because the statutory exemption of foreign time deposits from interest rate limitations was of limited application and temporary duration, reference to it was contained in a footnote rather than in the text of the new draft.

The footnote in the May 20 draft regarding time certificates with alternative maturities was phrased in the new draft in more general language to avoid reference to a specific period of notice of withdrawal.

To conform with Board interpretations, the prohibition of payment of interest after maturity of a time deposit was qualified in the new draft by a proviso permitting interest after maturity if the deposit was renewed within 10 days.

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Two Reserve Banks felt that forfeiture of three months' interest that had been paid on the amount of a deposit withdrawn before maturity was too harsh. However, the Legal Division did not share that view, and the provision was retained in the new draft.

The new draft attempted to simplify the rather complicated provisions regarding payment of savings deposits, along lines suggested by a Reserve Bank, but without any substantive change from the corresponding provisions of the May 20 draft.

In order to prevent the use of a savings account as the equivalent of a checking account, the May 20 draft prohibited arrangements for periodic transfers from savings deposits, but allowed exceptions for four types of transactions not involving payments to third persons. The memorandum suggested that the Board might wish to add a fifth exception that might be considered reasonable, namely, periodic transfers of specified amounts from a savings deposit to a checking account not more often than, say, 90 days.

At the Board's invitation Mr. Hackley summarized the steps that had been taken to develop a revision of Regulation Q and the present recommendations as to procedure. As to the latter, the Board's views were desired especially with respect to the relative merits of making a single maximum rate of interest for savings deposits (assuming that the Board was still of a mind to adopt such a rate) the subject of separate action, to be effective immediately upon publication, or including any such change in the over-all package of revisions of the regulation.

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Even though the purpose of such a change was to reduce the administrative burden, any rate change might have policy implications.

Chairman Martin then requested expressions of views from members of the Board, in response to which Governor Mills read the following statement:

The proposed revision of Regulation Q has the virtue of modernizing and simplifying the text of the existing Regulation. Substantively, the revised Regulation trends clearly toward a relaxation of standards established in accordance with the directive of the Federal Reserve Act and maintained for many years. A prime intent of Regulation Q was to divorce demand and time deposits so as to prohibit the iniquitous practice of paying interest on demand deposits, which had had deleterious effects on the quality of bank loans and investments. In order to make the prohibition of interest payments on demand deposits effective, it became necessary to prescribe the conditions under which interest would be payable on time and savings deposits. The philosophy was followed that savings deposits should represent the accumulation of savings on the part of individuals who would be entitled to savings interest as a reward for their thrift. According to this reasoning, business entities were precluded from receiving interest on deposits other than for time deposits represented by specific instruments and bearing specific maturities. These instruments are classified as time deposits open account and certificates of deposit. By restricting the payment of interest to business entities solely to time deposits, it was apparently reasoned that deposits placed with a bank for a specified period of time would be entitled to the payment of interest without breaching the principle that such payments would revive the evils that were inherent in the payment of interest on demand deposits. In order to prevent a drift backward in the direction of the payment of interest on demand deposits, the Board's Regulation Q over the years has also prescribed varying maximum ceiling rates of interest on different maturities of time deposits, with the shorter maturities allotted the lowest maximum permissible rates of interest.

The proposed revision of Regulation Q relaxes the principle embodied in the existing Regulation even beyond relaxations that have gradually grown into the Regulation in previous revisions. The revision of the Regulation now proposes to expand the area

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of organizations to be permitted to carry savings accounts to go beyond those "not operated for profit" and to include organizations "no part of the net earnings of which inures to the benefit of any private shareholder or individual." By virtue of the liberalized language, a large variety of nonprofit organizations will be allowed to carry savings accounts merely because they are not operated for profit. This liberalization violates the position that true savings deposits and accounts are those held by individuals whose thrift deserves encouragement and discards the position that as long as organizations can obtain interest on deposits through the mechanism of time deposits, there is no solid reason for permitting them the privilege of carrying savings accounts. The liberalization in the proposed revision, if adopted, will in all probability lead on to a complete elimination of the restrictions against even profit-earning organizations carrying savings accounts. This is a dangerous possibility considering the fact that many commercial banks are paying interest on savings accounts on a daily basis, which practice, if and when applied to the savings deposits of profit-earning organizations, would represent what would amount to a return to the payment of interest on demand deposits.

By the same token, the provision in the proposed Regulation doing away with any maturity distinction as to time deposits would, by allowing the same maximum permissible rate of interest on all maturities of time deposits, represent a step backward toward the payment of interest on demand deposits, in that a profit-earning corporation by obtaining interest, for example, on a 30-day time deposit would in effect be receiving what would be tantamount to interest on a demand deposit. The proposed liberalization permitting periodic transfers from savings deposits to demand checking account deposits will tend to blur the distinction now existing between savings deposits and demand deposits, and encourage requests for still further liberalization of such arrangements.

Those who believe that the prohibition of the payment of interest on demand deposits is desirable will unquestionably find fault with the proposed revision of Regulation Q, whose adoption will weaken the administration of a Federal statute which was enacted to correct evils in the practices of commercial banks which are tending to recur within the limitations of the existing Federal statute and the Federal Reserve Board's Regulation, and which should not be encouraged.

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Governor Mills added that the whole matter, as he saw it, was a question of philosophy, rationalization, and choice of thinking as to whether or not interest on demand deposits should be prohibited.

Governor Robertson expressed the view that there was a real need for revising Regulation Q, which contained obvious defects. Even if nothing else was done, the split maximum rate of interest on savings deposits, which imposed an undue burden on banks in calculating interest, should be eliminated. There had been some justification for the split when an increase in rate was newly-adopted, but that time had long since passed. He felt that in the process of revising the regulation there should be an attempt to solve the question relating to absorption of exchange charges; the question should not be passed over unless it was absolutely impossible to achieve agreement with the Federal Deposit Insurance Corporation, and he believed that the Board could and should get that agreement. The changes suggested by the Legal Division seemed to be called for, except that he had doubt as to the change in the language of the definition of savings deposits to refer to organizations "no part of the net earnings of which inures to the benefit of any private shareholder or individual." The proposed elimination of a dollar amount limitation on savings deposits of nonprofit organizations and trustees in bankruptcy was agreeable to him, but if the Board chose to retain a limitation, he would favor the Legal Division's subordinate suggestion that deposits of trustees in bankruptcy be exempt from that

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limitation. However, he had reservations as to the Division's further contingent recommendation that, if the limitation was retained as to deposits of trustees in bankruptcy, it be applied to each bankrupt estate rather than to the aggregate deposits of the trustee. He also questioned the provision permitting regular transfers from a savings account to effect payments on any loan made by the bank to the depositor. Transfers to pay loan installments previously had been allowed only for real estate loans owed by the depositor to the bank, and he feared that this broadening might be used for the operation of plans similar to the one operated by a bank near Chicago that had caused the Board much concern. It seemed conceivable that a bank might construe the provision as allowing transfers for any payments whatever that might arise from an open line of credit. In response, Mr. Hackley pointed out that another provision of the proposed revision prohibited withdrawals from a savings deposit to enable the bank to reimburse itself for credit extended by it through payment of checks or drafts drawn by the depositor upon the bank; it was anticipated that this prohibition would forestall the operation of plans such as that used by the bank in the Chicago area. Governor Robertson then remarked that if the prohibition referred to was adequate to prevent operation of such plans, he had no further objection to the provision allowing regular transfers from a savings account to pay installments on a loan owed by the depositor to the bank.

Governor Robertson continued by recommending that the Board consider revising the regulation specifically to prevent evasions of

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the maximum interest rates payable on savings deposits. He believed that, so long as it had in effect a regulation that imposed ceilings, the Board should not close its eyes to circumvention of those ceilings such as he considered to exist in the scheme of borrowing on unsecured notes inaugurated early in September by a bank in Boston and subsequently adopted by other banks. The statute that authorized national banks to borrow had limited such borrowing to 100 per cent of capital, but had been amended in 1959 to increase the limit to 100 per cent of capital and 50 per cent of unimpaired surplus. Legislative history showed that the purpose of that statute was to enable small banks that were subject to seasonal demand fluctuations to meet the needs of their customers by borrowing from other banks. There was no difference between funds obtained by banks through the issuance of certificates of deposit and funds obtained by issuing liabilities called notes, except that the funds obtained from notes were not subject to reserve requirements or to the maximum rates of interest in Regulation Q. Through the device of issuing notes, banks might be able, during periods of restrictive monetary policy, to get the funds they wanted without hindrance from any measures that might be taken to deter credit expansion through reserve requirements or maximum rates of interest. Moreover, the issuance of notes by relatively large banks put smaller banks at a competitive disadvantage, because their names were not such that there would be a ready market for their notes. Section 19 of the Federal Reserve Act

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authorized the Board to define demand and time deposits and to prescribe regulations to effectuate the purpose of the law and to prevent evasions. In order to carry out those purposes, Governor Robertson suggested for the Board's study the following definitions:

(a) Demand deposit - A "demand deposit" or a "deposit which is payable on demand" means any indebtedness of a member bank that arises out of a debtor-creditor relationship between the bank and another with respect to funds that are payable on demand, except (i) indebtedness due to a Federal Reserve Bank, (ii) indebtedness with respect to funds lent to the bank by another member bank for its own account, and (iii) indebtedness that is subordinated to the claims of the general creditors of the bank.

(b) Time deposit - A "time deposit" means any indebtedness of a member bank that arises out of a debtor-creditor relationship between the bank and another with respect to funds that are payable (1) on a specified date, (2) at the expiration of a specified period of time, or (3) upon notice in writing that is actually required to be given a specified time before the date of payment, except (i) indebtedness due to a Federal Reserve Bank, (ii) indebtedness with respect to funds lent to the bank by another member bank for its own account, and (iii) indebtedness that is subordinated to the claims of the general creditors of the bank.

This language, Governor Robertson believed, would bring unsecured notes within the category of deposits from the point of view of ceilings, and would preclude the use of the borrowing privilege for the purpose of circumventing a regulation applicable to deposits. There would have to be conforming amendments, of course, to Regulation D, Reserves of Member Banks. He did not believe that the proposed definitions would go beyond either the statute or the Board's prerogative, and they appeared to him to be a means of nullifying allegations that the Board would close its

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eyes to evasions of its regulation. He was not suggesting that the definitions be adopted at this time, but that they be sent to the Reserve Banks for comment, along with the proposed revision of the regulation. In the meantime, it would be helpful to have the staff analyze the suggested definitions from the viewpoints of the feasibility and desirability of preventing circumvention of the regulation through the use of notes, and of the potentialities of the use of notes to thwart the policy of the Board in times of restrictive monetary policy.

Governor Shepardson commented that, in general, he shared Governor Mills' concern as to whether the proposed revision, though containing desirable simplifications, might have the effect of further leveling the distinctions between demand, time, and savings deposits. He referred to Governor Robertson's point about evasion of the regulation through the use of unsecured notes, recalling that during an earlier discussion the thought had been expressed that if a serious problem of evasion developed, the regulation might in due course be amended to bring such notes within its scope. So long as there was a statute with known intent in this area, Governor Shepardson believed that the Board should attempt, within whatever authority it had, to draw a regulation in terms that would prevent what was admittedly an evasion of the present regulation through technicality. He regarded the split maximum rate of interest on savings deposits as a mistake, which should not be continued

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any longer than necessary. If there was prospect of being able to issue the complete revision of the regulation in the near future, it might be preferable to include abandonment of the split rate in the package. However, if the over-all revision would take, say, as much as a year, he thought it would be well to get rid of the split rate in much less time than that.

Governor Mitchell stated that he was quite troubled about the whole problem, though he agreed generally with the proposed revisions. His philosophy, quite different from Governor Mills', was that the regulation was a bar to healthy competition. He would like to see the interests of the depositors considered - not just the interests of banks that wanted to have a monopoly and yet to blame the Federal Reserve for what they did not want to do. He thought that the fundamental need was to produce a revision that would open up competition and that would come to grips with the major substantive issues, such as absorption of exchange charges. It would be misleading to adopt a revision without taking account of such issues, because it would be regarded by the public as the finished thinking of the Federal Reserve, whereas it would leave important problems unresolved. In his view, it might be desirable to allow a little more leeway in the structure of time rates in the months ahead, which would be done if the 4 per cent rate were allowed on certificates with a 30-day maturity instead of only on those with maturities of 90 days or more.

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Mr. Hackley commented that careful consideration had been given by the Legal Division to the possibility of including in the revision provisions to deal with the problem presented by the issuance of unsecured notes by member banks, and he had studied the language that Governor Robertson had offered for definitions of time and savings deposits intended to bring such notes within the scope of the regulation. However, it seemed to Mr. Hackley that the practice had not developed to the extent that thinking had become crystallized as to the best possibilities for meeting the situation, especially since the issuance of unsecured notes, among other matters, was being studied by an ad hoc subcommittee of the Presidents' Conference Committee on Bank Supervision. Since the subcommittee would submit its report to the Conference in December, and since the purpose of the revision of Regulation Q, as the Legal Division understood it, was administrative simplification, it had been thought that it might be premature to include in the revision at this time any language directed at unsecured notes. As for absorption of exchange charges, Mr. Hackley agreed that that was one of the principal questions relating to Regulation Q that was unresolved, but he had assumed that it was not one on which there was likelihood of reaching agreement with the Federal Deposit Insurance Corporation in the next few weeks. In those weeks, however, some progress might be made on the general revision of the regulation.

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Governor Robertson indicated that he would not advocate deferring sending the proposed revision to the Corporation and the Comptroller of the Currency in the hope of reaching a solution of the absorption of exchange question. It would be fine if a proposed solution could be included, but if it could not, the general revision might as well proceed.

Governor Daane said that the proposed changes in the regulation, as he understood them, seemed to represent improvement. He would like to get rid of the split maximum rate of interest, which he believed had implications regarding the 90-day minimum maturity for certificates that could draw 4 per cent interest. He saw no reason to hold up the revision, although he believed that the Board had to face up to the substantive questions. Unlike Mr. Hackley, he thought the Board knew pretty well what was going on with respect to the issuance of unsecured notes. He was convinced that the use of such notes was spreading to the point where medium-sized banks were entering into such transactions because the funds were thereby put on a different basis. The Board would have to do some hard thinking on the substantive questions, but as for now, he would send the proposed revision to the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Banks.

Governor Balderston referred to the provision of the new draft that paraphrased the statutory prohibition of payment of interest on

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demand deposits "directly or indirectly, by any device whatsoever," and asked if it might be possible to drop the word "indirectly," which had given rise to many problems of interpretation.

Mr. Hackley responded that so long as that phrase was in the law, it did not seem feasible to delete it from the related provision in the regulation at this point. He continued with comments on types of payments for funds that had been considered for coverage in the revised regulation but for which handling by Board interpretation rather than by regulation had seemed preferable. One example of such practices was the procurement of funds in certificates of deposit through agents.

As to procedure, Governor Balderston said he favored sending the new draft of regulation to the Comptroller of the Currency and the Federal Deposit Insurance Corporation without delay. As to the substantive issues, it seemed to him that the question raised by Governor Robertson regarding the use of unsecured notes should have prompt attention, before their volume became so large that a ruling by the Board would be disturbing to banks. Perhaps the letter to the Federal Deposit Insurance Corporation could stress the need for agreement on the question of absorption of exchange charges. The several necessary steps would take time. His general thought was that, the replies from the other Federal banking authorities having been received and considered, it might be possible about in January to issue a

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revised regulation along with an announcement about the abandonment of the split maximum rate of interest on savings deposits, and that work might be going forward in the meantime to enable the Board to make a ruling at the same time relating to unsecured notes.

Chairman Martin also expressed the view that the proposed revision of Regulation Q should be sent to the Comptroller and to the Federal Deposit Insurance Corporation. Also, the Board should try to straighten out the split maximum rate of interest, which had caused a great deal of trouble. It involved a practical operating problem in making calculations that was a real burden for banks.

Governor Mills voiced the opinion that the nature of the press release the Board had issued on September 9, 1964, regarding the use of unsecured notes had invited the troubles that were now being faced. However, the solution proposed in Governor Robertson's suggested definitions of time and savings deposits could evoke the same problems the Board had encountered in trying to define indirect payment of interest in such a way as to include absorption of exchange charges. To attempt to bring unsecured notes within the scope of the interest limitations in Regulation Q, Governor Mills believed, would be a distortion of the statute and had overtones of going through the back door. Presumably, the Legal Division would have to make an exhaustive review as to whether there was any legal prohibition of the issuance of unsecured notes, and, with the antecedent of the ruling

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on "borrowed money" published in the August 1964 Federal Reserve Bulletin, it would be difficult to find that the issuance of unsecured notes was legally prohibited. Any ruling the Board might issue would have to be thought out very cautiously.

Mr. Hackley then sought the views of the Board with respect to three specific points in the new draft of regulation. The first related to the reference, in the definition of savings deposits, to organizations "not operated for profit," which in the new draft had been changed to organizations "no part of the net earnings of which inures to the benefit of any private shareholder or individual." The latter language was used in the Internal Revenue Code and in the Bank Holding Company Act, and there appeared to be considerable merit in using it in Regulation Q.

Second, Mr. Hackley drew attention to the elimination in the new draft of an amount limitation on savings deposits of nonprofit organizations and trustees in bankruptcy, whereas the May 20 draft had specified a limitation of \$25,000 for such deposits.

The majority of the members of the Board expressed agreement with both of the changes mentioned by Mr. Hackley.

Third, Mr. Hackley pointed out that the May 20 draft, like the present regulation, limited savings deposits to deposits with respect to which the depositor is required, or may at any time be

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required, by the bank to give not less than 30 days' written notice of withdrawal. This was narrowed in the new draft to deposits as to which 30 days' written notice "may at any time be required," thus excluding deposits as to which such notice "is required" by the deposit contract.

Discussion brought out that the changed language would be significant from the point of view of payment of interest: a deposit as to which the deposit contract merely reserved the right of the bank to require notice of withdrawal would be a savings deposit, whereas a deposit as to which the contract specified a requirement of notice would be a time deposit and could earn interest at no more than the rate allowed for certificates of deposit with a maturity equal to the term of notice required. However, the new language might cause confusion, since the deposit contracts of many banks contained a reservation of the right to require notice of withdrawal (though seldom invoked by the bank), and through many years of banking practice deposits accepted under those contracts as savings deposits had continued to be treated as savings deposits even though they were subject to a specific maturity.

Members of the Board indicated that this point might be left to the discretion of the Legal Division, and Mr. Hackley expressed the view that it might be better to retain the definition now in the regulation.

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Governor Mitchell commented that the proposed definition of payment of interest as "any payment to or for the account of the depositor as compensation for such deposit" would mean to him, as he thought it would to the ordinary citizen, that a bank could absorb the costs of servicing accounts of its regular customers, but could not pay cash to the customers (the May 20, 1964, draft of revision had included a provision allowing "premiums" of a value of not more than \$5 to be given for advertising purposes).

Mr. Hackley said that two points were involved: first, the law prohibited payment of interest directly or indirectly; and second, the Board was authorized to define what constituted payment of interest. The Board had said by interpretation that costs of servicing accounts did not involve payment of interest. It could change that interpretation, just as it could change its position on absorption of exchange charges.

Governor Mitchell then remarked that allowing banks to absorb servicing costs, even though not to pay cash to customers, did not seem far from allowing absorption of exchange charges.

The discussion then turned to the outlook for a change in the position of the Federal Deposit Insurance Corporation regarding absorption of exchange charges, and problems of timing in raising the question anew with the Corporation. There was majority agreement that the letter transmitting the proposed revision of Regulation Q to the Corporation

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for comment should also request the current views of the Corporation on the question of absorption of exchange charges, and ask comments on the suggestion that deposits be defined so as to include funds obtained through issuance of notes, and on the desirability of abandoning the split maximum rate of interest on savings deposits. It was understood that the letter transmitting the proposed revision of the regulation to the Federal Reserve Banks would also ask comments on covering funds obtained through issuing notes into the definition of deposits, but that that query would not be included in the letter to the Comptroller of the Currency, whose position regarding the issuance of notes was already a matter of record.

Pursuant to the agreement expressed by a majority of the members of the Board, letters were sent on October 20, 1964, to the Chairman of the Federal Deposit Insurance Corporation, to the Comptroller of the Currency, and to the Federal Reserve Bank Presidents in the forms attached as Items 5, 6, and 7.

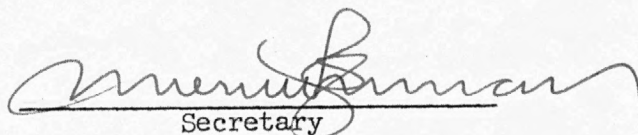
Governor Mills asked that his dissent be recorded, commenting that he had not heretofore taken a position because he had hoped that the views expressed by the Federal Reserve Banks might be more in the direction of his thinking, but that the whole program for revision of Regulation Q was now so far advanced that he wished the record to show his philosophical antipathy to the trend of thought it embodied.

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The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board a memorandum from the Division of Administrative Services recommending an increase in the basic annual salary of Wilbert L. Stephens, Assistant Head Messenger in that Division, from \$4,180 to \$4,545, effective October 25, 1964.


Secretary

UNITED STATES OF AMERICA

Item No. 1
10/15/64

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Application of
STATE BANK OF ALBANY
for approval of merger with
The First National Bank of Cairo

ORDER APPROVING MERGER OF BANKS

There has come before the Board of Governors, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), an application by State Bank of Albany, Albany, New York, a State member bank of the Federal Reserve System, for the Board's prior approval of the merger of that bank and The First National Bank of Cairo, Cairo, New York, under the charter and title of State Bank of Albany. As an incident to the merger, the two offices of The First National Bank of Cairo would become branches of State Bank of Albany. Notice of the proposed merger, in form approved by the Board, has been published pursuant to said Act.

Upon consideration of all relevant material in the light of the factors set forth in said Act, including reports furnished by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Department of Justice on the competitive factors involved in the proposed transaction,

IT IS HEREBY ORDERED, for the reasons set forth in the Board's Statement of this date, that said application be and hereby is approved, provided that said merger shall not be consummated

- (a) within seven calendar days after the date of this Order, or
- (b) later than three months after said date.

Dated at Washington, D. C., this 15th day of October 1964.

By order of the Board of Governors.

Voting for this action: Chairman Martin, and
Governors Balderston, Mills, Shepardson, Mitchell,
and Daane.

Voting against this action: Governor Robertson.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

(SEAL)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
APPLICATION BY STATE BANK OF ALBANY
FOR APPROVAL OF MERGER WITH
THE FIRST NATIONAL BANK OF CAIRO

STATEMENT

State Bank of Albany, Albany, New York ("State Bank"), with total deposits of \$391 million, has applied, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), for the Board's prior approval of the merger of that bank and The First National Bank of Cairo, Cairo, New York ("Cairo National"), which has total deposits of \$6 million.^{1/} The banks would merge under the charter and name of State Bank, which is a member of the Federal Reserve System. As an incident to the merger, the two offices of Cairo National, one of which is presently a seasonal agency located at Greenville, New York, would become branches of State Bank, increasing the number of its offices from 24 to 26.

Under the law, the Board is required to consider, as to each of the banks involved, (1) its financial history and condition, (2) the adequacy of its capital structure, (3) its future earnings prospects, (4) the general character of its management, (5) whether its corporate

^{1/} Deposit figures are as of December 20, 1963.

powers are consistent with the purposes of 12 U.S.C., Ch. 16 (the Federal Deposit Insurance Act), (6) the convenience and needs of the community to be served, and (7) the effect of the transaction on competition (including any tendency toward monopoly). The Board may not approve the transaction unless, after considering all of these factors, it finds the transaction to be in the public interest.

Banking factors. - The financial histories of State Bank and Cairo National are satisfactory, and each bank has a sound asset condition and an adequate capital structure. State Bank's earnings record is good and its future earnings prospects are favorable. Although the gross income of Cairo National has been above the average for banks of comparable size in the Second Federal Reserve District, it has realized less-than-average net earnings during the past two years due to its relatively high expenses. The bank's future earnings prospects are considered to be reasonably satisfactory.

While the management of Cairo National is satisfactory, the bank has a management succession problem. The bank's chief executive officer, who is past the usual retirement age, wishes to leave the bank and, thus far, the bank's efforts to replace him have been unsuccessful. Consummation of the transaction would solve this problem, as the resulting bank would be under the capable and aggressive management of State Bank. The resulting bank also would have a sound financial condition, an adequate capital structure, and favorable future prospects.

The corporate powers of the two banks are not, and those of the resulting bank would not be, inconsistent with the purposes of 12 U.S.C., Ch. 16.

Convenience and needs of the community. - Cairo National, the only bank in Cairo, is located in the Catskill Mountains of Greene County, New York, approximately 40 miles southwest of the main office of State Bank in Albany. The service area^{2/} of Cairo National consists of Cairo, the adjacent towns of Greenville and Durham, all located in the northeastern section of Greene County, and the towns of Rensselaerville and Westerlo, both located in the southwestern portion of adjoining Albany County. There is no other banking office in the service area of Cairo National. The banking offices nearest to Cairo are some 10 miles distant.

The economy of the service area of Cairo National is dependent for the most part upon the summer tourist trade, and its residents include many retired persons. The normal population of the service area is about 7,500, but rises to around 40,000 during the summer months. Cairo National's deposits are subject to wide seasonal fluctuations, as is usual for banks located in resort areas. Deposit volume is generally at the low point when loan demand is at the peak and, conversely, when deposit volume is high, loan demand is low.

^{2/} The area from which a bank obtains 75 per cent or more of its deposits of individuals, partnerships, and corporations ("IPC deposits").

Cairo National offers the range of banking services commonly provided by small local banks. However, it does not offer trust services or investment counseling services, both of which must presently be sought from banks located outside the service area of Cairo National. In addition, although it follows a rather restrictive lending policy, there is evidence that Cairo National's relatively low lending limit renders it unable to serve adequately the credit needs of some businesses in the area. State Bank would provide for the community now served by Cairo National a greater variety of banking services and would be fully able to cope with the inverse fluctuations in deposits and loan demand which are characteristic of the area's banking business.

The banking convenience and needs of the areas presently served by State Bank would not be materially affected by consummation of this proposal.

Competition. - The nearest offices of State Bank to Cairo are some 15, 19, and 29 miles distant, respectively, located on the opposite side of the Hudson River and accessible to the residents of Cairo National's service area only by use of a toll bridge. While State Bank could enter Greene County through the establishment of de novo branches, it could not, because of the home-office-protection feature of State law, expand by this method into the more significant towns.

Cairo National is the largest commercial bank headquartered in Greene County. National Commercial Bank and Trust Company of Albany ("National Commercial"), the second largest bank in New York's Fourth

Banking District in terms of total deposits, operates a branch in Greene County at Athens, about 13 miles from Cairo. Four other commercial banks, each essentially local in character, operate a total of five offices in Greene County which are situated within a range of about 10 to 21 miles from Cairo. There is no significant overlapping of the service area of Cairo National with the service area of any other commercial banking office; nor is there any evidence that the presence of the Athens branch of National Commercial has had any adverse competitive effect on the other commercial banks operating in Greene County. This would seem to be attributable in large part to the nature of the local economy and the tendency of the mountainous terrain to intensify the localization of banking competition. For similar reasons, it would seem that the competitive situation with respect to the remaining small banks in the area would not be materially affected by consummation of the proposed merger.

There were 43 commercial banks in New York's Fourth Banking District at the end of 1963. Of the 167 commercial banking offices in the District, State Bank and National Commercial operated 24 and 38, respectively. State Bank, with 25 per cent of the total commercial bank deposits in the District, was the largest, and National Commercial, with 23 per cent of such deposits, was the second largest. On the basis of commercial bank IPC deposits alone, State Bank held 20.4 per cent and National Commercial held about 21 per cent. The acquisition of Cairo National would increase State Bank's share of IPC and total commercial bank deposits in the District by only four-tenths of one per cent each.

Summary and conclusion. - If consummated, this merger would replace the only bank in Cairo with a branch of one of the two largest banks in the Fourth Banking District of New York. The concentration in banking resources in this District was an important factor in the Board's decision denying the application of State Bank to merge with the Unadilla National Bank. However, in the present case the total of the circumstances differs significantly. See 49 Federal Reserve Bulletin 631 (1963).

Consummation of the merger with Cairo National would increase State Bank's present 25 per cent share of the District's total commercial bank deposits by less than one-half of one per cent. It does not appear that other banks would be exposed to adverse competitive effects as a result of the merger, or that any significant existing or potential competition would be eliminated. Further, in addition to solving the management succession problem of Cairo National, the merger would result in a bank better able to serve the banking needs and convenience of the community concerned.

Accordingly, the Board finds that the proposed merger would be in the public interest.

October 15, 1964.

DISSENTING STATEMENT OF GOVERNOR ROBERTSON

Two formidable opponents, one a national, the other a State member bank, are engaged in a race to dominate the Fourth Banking District of New York. At the end of 1963, the two between them held 48 per cent of total commercial bank deposits and 37 per cent of commercial banking offices in the District. Citing this situation, the Board, in its Order of April 26, 1963, denied the application of the State member to merge Unadilla National Bank, a healthy \$4.7 million institution in a prosperous agricultural region, Otsego County, in the District's southwest corner. (1963 Federal Reserve Bulletin 631) However, not long after, the Comptroller authorized the rival to merge a small bank in the same county. Now the State member comes to the Board again, hat in hand, and asks to be allowed to catch up.

Although consistency in governmental administrative decisions is not easily achieved, it is a characteristic devoutly to be sought. Today, in the bank supervisory field, it seems to be especially elusive. The Board, by its approval of the application in this case, permits and encourages the same kind of increase in banking concentration which it sought to discourage eighteen months ago.

Like the Unadilla bank, Cairo National is a small but sound, growing, and profitable bank with satisfactory prospects. Indeed, in my judgment, for the purpose of this application, the two situations are indistinguishable - except that Cairo is a resort community

(with no industry and little commercial activity), whereas Unadilla is in the heart of a farming area. Surely the needs of a farming area for adequate banking facilities are at least equally important from an economic point of view with those of a resort area.

The following quotation from the Board's decision in the Unadilla case, with no more than parenthetical insertions as to name and location to adapt it to the present situation, squarely covers and should govern the disposition of the application now before the Board:

"If approved, this merger would replace the only bank in Unadilla (Cairo) with a branch of one of the two largest banks in the Fourth Banking District of New York having its main office 100 (40) miles away, and would constitute one more step in a significant series of bank absorptions by State Bank. There is no substantial evidence that the banking needs or convenience of the Unadilla (Cairo) area are not being served adequately, or that Unadilla National (Cairo National) cannot continue its operations profitably. Any benefits that might accrue to the public as a consequence of the merger would be more than offset in the circumstances of this case by the increase in the size of the largest bank in the Fourth Banking District of New York, by the increase in the already high concentration of banking resources in that District, and by the adverse potential effect on banking competition in Unadilla (Cairo) and the surrounding area."

In this language, the Board clearly recognizes that the Bank Merger Act (as reflected in its legislative history) requires a very positive showing of public benefit under the other criteria set forth in the statute to offset competitive considerations which are as patently adverse as those in the Unadilla or the Cairo situation. In the present case, as was true in the previous one, there is no substantial evidence in the record that the banking needs or convenience of the area concerned are not being served adequately, or that the bank to be acquired could not continue its operations profitably.

What of competitive considerations? In Unadilla, like Cairo a one-bank town, the Board was concerned with a trade area containing eight offices of modest-sized, thriving banks. The Board found that "Expansion by State Bank into the Unadilla area would expose the . . . [nearest] bank . . . and also the other six banking offices located from 10 to 16 miles from Unadilla, to the strong competitive capabilities of a significantly larger bank". Is the threat to the remaining small local banks any less in the Cairo area? Five independent banks within a radius of 21 miles from Cairo, none even as large as the larger institutions in the vicinity of Unadilla, are already struggling to compete with a branch of the vigorously aggressive National Commercial Bank, State Bank's rival. Approval of the present application subjects the remaining four to the "strong competitive capabilities" of a second "significantly larger" bank.

True, the record shows that in a few isolated instances, the Cairo bank has been unable or unwilling to respond to requests for credit - in 1963 the bank found it necessary to participate one loan because of its low lending limit. But the local branch of the other big Albany bank is already there to meet any community needs and convenience which cannot be satisfied by banks headquartered in the area. To admit a second big bank will only deprive the remaining smaller ones of the few attractive crumbs still remaining on the table.

The majority also mentions a management succession problem as a factor weighing in favor of approval of the application.

But it is hard to believe, as someone else has said, that a bank with assets in excess of six million dollars and operating income of over \$240,000 per year is incapable of providing sufficient emoluments to obtain the services of one qualified, full-time executive officer. Certainly management problems may weigh in favor of approval in some instances. However, to give significance to this factor in a case like the present one will encourage other small banks similarly situated to neglect planning for management succession -- a tendency to be decried.

Finally, it is alleged in the record that the prime incentive for the merger is the desire of the shareholders of the Cairo bank to sell their stock. However, the premium being paid - nearly \$350,000 in excess of book value and approximating 6.4 per cent of the bank's deposits - would seem to indicate that an even stronger incentive is the desire of the big bank to "buy" another office. If supervisory authorities continue to permit bank acquisitions - aided by the lure of such lush premiums - which have no more to justify them than appears in the record of this case, then the continuing trend toward concentration of banking power in large banks, able to pay attractive prices, will surely hasten the demise of small banks - including those in the Fourth Banking District which may fall under the covetous eye of State Bank or National Commercial in their race for dominance.

I would disapprove the application.

October 15, 1964.

October 13, 1964.

TO: Board of Governors
FROM: Ralph A. Young
SUBJECT: Foreign travel: Mr. A. B. Hersey
Mr. John E. Reynolds

Two international meetings will be held in the next few weeks to consider the statistics required for multilateral surveillance, by the Group of Ten, of "liquidity creation" and balance-of-payments settlements.

On October 22 and 23, the Esteva Group (the Group of Ten's working party on this question) will meet in Paris. On November 9 to 11, central bank economists will meet at the BIS in Basle (continuing the series of semi-annual meetings on various subjects). Both meetings will consider the national statistics presently being submitted in connection with surveillance, with particular attention to their content, to differences among countries in statistical concept and coverage, to possible reconciliation of items, and to the purposes that such statistics may serve.

It is recommended that Mr. John E. Reynolds attend the Paris meeting in October, that Mr. A. B. Hersey attend the Basle meeting in November, and that they receive the per diem in lieu of expenses authorized by the Standardized Government Travel Regulations.

Mr. George Willis of the Treasury will head the U.S. delegation to the Esteva Group meeting in Paris. Mr. George Garvy of the Federal Reserve Bank of New York will join Mr. Hersey at the Basle meeting.

Ray

Item No. 5
10/15/64

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 20, 1964.

The Honorable Joseph W. Barr, Chairman,
Federal Deposit Insurance Corporation,
Washington, D. C. 20429

Dear Mr. Barr:

For more than a year, the Board of Governors has had under consideration a possible revision of its Regulation Q that would make administration of this Regulation less difficult and time consuming. As you know, the Regulation in the past has frequently given rise to troublesome questions of interpretation.

Enclosed is a draft dated October 20, 1964, of a proposed revision of the Regulation, together with an explanatory memorandum and a comparative draft showing textual changes that would be made in the present Regulation.

The views and comments of your Corporation regarding the proposed revision will be appreciated. It is hoped, of course, that, if and when such a proposed revision is submitted to the Federal Register for comments by the public, a similar revision of the corresponding regulations of your Corporation would be proposed at the same time.

The proposed revision would not deal with the question whether absorption of exchange charges constitutes a payment of interest on deposits. However, as indicated in the explanatory memorandum, resolution of this long-standing problem at an early date would be highly desirable, whether in connection with or apart from the proposed revision of the Regulation. The Board would be glad to have your current views as to this matter.

Recent announcements by some banks of proposed borrowings by them through the issuance of short-term notes have given rise to concern on the part of the Board as to whether the development of such a practice might tend to make regulation of interest rates on deposits less effective. The Board would like to have your views as to whether consideration should be given to an amendment to Regulation Q and your corresponding regulations that would define deposits to include funds obtained through the use of notes of the kind in question and, if so, the form that any such amendment should take.

The Honorable Joseph W. Barr -2-

Since January 1, 1962, the maximum rate of interest prescribed by the Board and your Corporation for savings deposits of member banks and nonmember insured banks has been 4 per cent for deposits that have remained on deposit for 12 months or more and 3-1/2 per cent for deposits that have been on deposit for less than 12 months. Such a "split" rate has occasioned questions of interpretation and administrative problems for banks. The Board, therefore, is considering the desirability, solely for administrative reasons, of establishing a single 4 per cent maximum rate for savings deposits, irrespective of the time the deposit has remained in the bank. It is contemplated that any such action would be taken at an appropriate time without prior publication of notice of the action in the Federal Register for comments by the public. The Board would like to have your views as to the desirability of such action.

It would be appreciated if the Board could receive your views and comments regarding the above matters not later than November 20, 1964.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosures

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

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Item No. 6
10/15/64

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD



October 20, 1964.

The Honorable James J. Saxon,
Comptroller of the Currency,
Treasury Department,
Washington, D. C. 20220

Dear Mr. Saxon:

For more than a year, the Board of Governors has had under consideration a possible revision of its Regulation Q that would make administration of this Regulation less difficult and time consuming. As you know, the Regulation in the past has frequently given rise to troublesome questions of interpretation.

Enclosed is a draft dated October 20, 1964, of a proposed revision of the Regulation, together with an explanatory memorandum and a comparative draft showing textual changes that would be made in the present Regulation.

The Board would be glad to have any views and comments that you might wish to offer regarding the proposed revision of Regulation Q. It would be appreciated if any such views or comments could be received by the Board not later than November 20, 1964.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosures

3566

Item No. 7
10/15/64

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 20, 1964.



Dear Sir:

There is enclosed a revised draft dated October 20, 1964, of a proposed revision of the Board's Regulation Q, that has been prepared in the light of comments of the Federal Reserve Banks with respect to a previous draft of May 20, 1964.

Copies of the revised draft have been sent to the Federal Deposit Insurance Corporation and the Comptroller of the Currency with a request for their comments by November 20, 1964. The Board will, of course, be glad to have any further comments that your Bank may wish to submit.

Recent announcements by some banks of proposed borrowings by them through the issuance of short-term notes have given rise to concern on the part of the Board as to whether the development of such a practice might tend to make regulation of interest rates on deposits less effective and also permit substantial avoidance of reserve requirements. The Board would like to have your views as to whether consideration should be given to amendments to Regulation Q and Regulation D that would define deposits to include funds obtained through the use of notes of the kind in question and, if so, the form that any such amendment should take.

Very truly yours,

A handwritten signature in dark ink, appearing to read "Merritt Sherman".

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.