Minutes for March 10, 1965.

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. Robertson _____

Gov. Balderston _____

Gov. Shepardson _____

Gov. Mitchell _____

Gov. Daane _____

Minutes of the Board of Governors of the Federal Reserve System on Wednesday, March 10, 1965. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Robertson, Acting Chairman
Mr. Shepardson
Mr. Mitchell
Mr. Daane

Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Director, Division of Examinations
Mr. Hooff, Assistant General Counsel
Mr. Leavitt, Assistant Director, Division of Examinations
Miss Hart, Senior Attorney, Legal Division
Mrs. Ulrey, Economist, Division of Research and Statistics
Messrs. Egertson and McClintock, Supervisory Review Examiners, Division of Examinations

Voluntary credit restraint effort. Governor Robertson indicated that he was arranging a meeting at the Federal Reserve Building on Monday, March 15, to be attended by officers of the Federal Reserve Banks designated by their Presidents as having responsibility for administration of the voluntary program to restrain foreign lending and investment. The general purpose of the meeting would be to answer such questions as might be raised by the Reserve Bank officers and to work toward a uniform approach throughout the Federal Reserve System.

In reply to a question, Governor Robertson said it was recognized that the President of each Reserve Bank would head up the responsibility for the program at his Bank and would undertake the bulk of the discussions with financial institutions. A meeting with the Presidents

would be planned on Tuesday, March 23, to discuss the progress of the voluntary program, this being the day when the Presidents would be in Washington for a meeting of the Federal Open Market Committee. Obviously, however, the Presidents could not personally administer all phases of the Reserve Bank functions incident to the program, and the persons attending next Monday's meeting would be the principal officers designated by the respective Presidents for administrative purposes.

Reports on competitive factors. Reports to the Comptroller of the Currency on the competitive factors involved in the following proposed mergers or similar transactions were approved unanimously for transmittal to the Comptroller in a form in which the conclusions were stated as follows:

Merger of First National Bank of Gate City, Gate City, Virginia, into Virginia National Bank, Norfolk, Virginia

There appears to be little, if any, competition existing between First National Bank of Gate City and Virginia National Bank, Norfolk.

Consummation of the proposed merger would expand Virginia National's geographical coverage in the far southwestern portion of the State, and continue the trend in Virginia toward the grouping of commercial banks into large aggregations with a consequent decline in locally headquartered banking outlets.

Merger of The Peoples National Bank of Farmville, Farmville, Virginia, into Virginia National Bank, Norfolk, Virginia

While the proposed merger of The Peoples National Bank of Farmville into Virginia National Bank, Norfolk, would eliminate little competition existing between them, it would expand Virginia National's geographical coverage in the central section of the State and expose the smaller banks in the Farmville area to the competitive capabilities of a substantially larger institution.

Consummation of the transaction would continue the trend in Virginia toward the grouping of commercial banks into large aggregations with a consequent decline in locally headquartered banking outlets.

Purchase of assets and assumption of liabilities of Martin State Bank, Martin, Michigan, by The First National Bank and Trust Company of Kalamazoo, Kalamazoo, Michigan

The proposed purchase of assets and assumption of liabilities of Martin State Bank by First National Bank and Trust Company of Kalamazoo would eliminate competition that exists between the two banks, and would increase the volume of deposits and branch office representation of the largest bank in Kalamazoo. The competitive effects of the proposed transaction would be adverse.

Application of Commercial State Bank (Item No. 1). On February 26, 1965, the Board concluded that the application for membership in the Federal Reserve System of Commercial State Bank, Boise, Idaho, a newly-organized bank that had not yet begun operations, should be denied because the proposed capital structure was inadequate. It was understood that a letter would be sent to the bank's organization committee indicating that the application had been denied for this reason, and in the same letter a comment would be made reflecting the Board's knowledge of the true ownership of the stock of the bank. A copy of the letter was to be sent to the Idaho State banking authorities so that they would be informed officially concerning the true ownership of the bank. The Board also indicated, however, that the matter might be discussed with the Federal Reserve Bank of San Francisco, and this was done subsequent to the meeting. On the basis of that discussion the Division of Examinations recommended in a

distributed memorandum dated March 2, 1965, an approach differing somewhat from the procedure previously envisaged. A letter would be sent to the organization committee of the bank approving the bank's membership application subject to the two standard conditions of membership and two special conditions: (1) that at the time of admission to membership the bank have total capital funds of not less than $750,000; (2) that the Board of Governors be provided with satisfactory evidence that the State banking authorities had been informed of the true ownership of the bank.

In discussion Governor Robertson indicated that he would favor a procedure whereby a letter would be sent to the bank's organization committee stating that the membership application was denied on the basis of capital inadequacy, that a new membership application could of course be submitted on the basis of additional capital being provided (which matter the organizers might want to discuss with the Federal Reserve Bank), and that if such an application was approved one of the conditions would be that the bank must provide the Board evidence that the State banking authorities had been informed of the true ownership of the bank.

This approach was generally favored and was considered preferable to a possible alternative, also mentioned during the discussion, under which the bank's organization committee would be advised that the Board was prepared to deny the membership application unless additional capital was supplied and the identity of the bank's ownership was made known to the State banking authorities.

Accordingly, unanimous approval was given to a letter to the bank's organization committee in the form attached as Item No. 1.

Question under Regulation U (Item No. 2). There had been distributed a memorandum from the Legal Division dated March 3, 1965, regarding a question presented by the Federal Reserve Bank of Boston as to whether New England Merchants National Bank of Boston, Boston, Massachusetts, could accept in good faith, within the meaning of section 221.3(a) of Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks, "nonpurpose" statements submitted by mail under a plan the bank was advertising whereby it offered to make installment loans for up to 70 per cent of the redemption value of any acceptable mutual fund shares pledged by the borrower as collateral. The memorandum brought out that in a letter of July 30, 1964, the Board held that another national bank in Boston could not accept similar statements in good faith within the meaning of Regulation U under essentially similar circumstances. However, no interpretation based on that letter had been published.

The Board's staff had reached the conclusion that the position taken on the earlier occasion, namely, that nonpurpose statements obtained by mail under a plan of this kind would not meet the requirements of Regulation U, seemed equally applicable to the plan of New England Merchants National Bank. Attached to the memorandum was a draft of letter to the Federal Reserve Bank of Boston reflecting this view,

and it was recommended that an interpretation along the lines of the draft letter be published in the Federal Register and the Federal Reserve Bulletin to place other banks on notice.

After discussion of the situation in light of the Board's statutory responsibilities for the regulation of loans for the purchasing or carrying of registered stocks, the members of the Board expressed their views on the position that should be taken.

Governor Robertson said that if the Board were to approve the plan described in the memorandum, he felt that the intent of Regulation U would be nullified. He believed that persons would be inclined to indicate more readily, on a printed statement received by them through the mail, that a loan was not a purpose loan than if they had to make such a statement in the presence of, and after discussion with, a bank officer.

Governor Shepardson said that under the mandate given to the Board by statute he felt that no other approach than the one recommended by the Legal Division could properly be taken. If such a position were taken, borrowers could obtain loans on the collateral of acceptable mutual fund shares by going to the nearest office of their bank. This should be no significant deterrent, while at the same time it might tend to prevent abuses.

Governor Mitchell expressed the opinion that if an individual would make a false statement in a document mailed to a bank, that individual probably would also make a false statement on the bank

premises. He did not see that there was justification for drawing a distinction. Individuals would be denied a convenient method of borrowing, and banks would be prevented from offering a reasonable service to their customers.

Governor Daane indicated agreement with the conclusion and recommendation of the Legal Division.

Accordingly, the letter to the Federal Reserve Bank of Boston was approved, Governor Mitchell dissenting, with the understanding that an interpretation based on the letter would be published in the Federal Register and the Federal Reserve Bulletin. A copy of the letter is attached as Item No. 2.

Question relating to sale of bank money orders (Item No. 3). Mr. Hackley recalled that on previous occasions, most recently at the meeting on February 24, 1965, the Board had discussed a proposed letter with regard to the question, raised by a State member bank through the Federal Reserve Bank of Cleveland, whether the issuance of money orders by an authorized agent of a State member bank would involve the operation of a branch. The proposed letter would express the opinion that the issuance of a bank's money orders by an authorized agent would not involve the receipt of deposits at a branch place of business and, accordingly, would not require the Board's permission to establish a branch. Up until February 24, neither the Federal Deposit Insurance Corporation nor the Comptroller of the Currency had replied to the Board's

request for comments on the matter, and it was decided by the Board that the so-called "Dillon procedure" should be followed before the letter was sent.

Mr. Hackley reported that letters had now been received from the Treasury, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation interposing no objection to the Board's taking the position stated in the proposed letter. Accordingly, the sending of the letter was approved unanimously, with the understanding that the interpretation contained therein would be published in the Federal Register and the Federal Reserve Bulletin. A copy of the letter to the Federal Reserve Banks is attached as Item No. 3.

The meeting then adjourned.

Secretary's Notes: Governor Shepardson today approved on behalf of the Board the following items:

Memorandum from June E. Burns, Administrative Assistant, Division of Personnel Administration, requesting permission to engage in activities incidental to the rental of a house.

Memorandum from Susan D. Chapman, Personnel Clerk, Division of Personnel Administration, requesting permission to work as Admitting Clerk at the Washington Hospital Center.

Acting in the absence of Governor Shepardson, Governor Robertson today approved on behalf of the Board a memorandum from Ethel A. Bergstein, Statistical Clerk, Division of Data Processing, requesting permission to work for Bergstein Temporary Help Service.

Assistant Secretary

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

Item No. 1
3/10/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 12, 1965.

Organization Committee,
Commercial State Bank,
Boise, Idaho.

Gentlemen:

This refers to the application made on behalf of Commercial State Bank, Boise, Idaho, for stock in the Federal Reserve Bank of San Francisco. In view of the bank's expected growth, proposed capital structure is considered inadequate, and, therefore, the application has been denied. The Board would consider a new application based upon more adequate capital, and your committee may wish to discuss this feature with officers of the Federal Reserve Bank of San Francisco. However, admission to membership would not be approved if the actual ownership of Commercial State Bank has not been officially revealed to the State authorities.

Very truly yours,

Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 2
3/10/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 10, 1965.

Mr. Laurence H. Stone, Secretary and
Associate General Counsel,
Federal Reserve Bank of Boston,
Boston, Massachusetts. 02106

Dear Mr. Stone:

This refers to your letter of December 29, 1964, in which you ask for the Board's views on the question whether New England Merchants National Bank of Boston ("Merchants") can accept in good faith, within the meaning of section 221.3(a) of the Board's Regulation U, "nonpurpose" statements submitted by mail under a plan Merchants has recently been advertising. Regulation U covers, of course, "Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks."

Under the plan, Merchants offers to make installment loans for up to 70 per cent of the redemption value of any acceptable mutual fund shares pledged by the borrower as collateral. A customer may either go personally to one of Merchants' offices, or mail in a loan application, but the problem before the Board does not arise unless he chooses to apply by mail.

Among material to be completed by the borrower on the application form is the following:

> "I/We state that this loan is for the following purpose (describe briefly): _____
> _____
> and that it is not for the purpose of purchasing or carrying mutual fund shares or any securities registered on a national securities exchange."

Regulation U, of course, limits the amount a bank may lend against collateral consisting of stock, where the loan is "directly or indirectly" for the purpose of purchasing or carrying stocks registered on a national securities exchange (so-called "purpose loan"), and places upon a bank the responsibility for taking appropriate action to determine the true purpose of a proposed loan.

Mutual fund shares are "stock" for purposes of Regulation U, and under § 221.3(b)(2) shares issued by some open-end investment companies are deemed to be registered stocks. Consequently, the loans are secured by stock, and are purpose loans if they are for the purpose of purchasing such mutual fund shares (or other registered stocks). At present, a bank may lend no more than 30 per cent of the current market value of stock collateral if the loan is a purpose loan, so that the regulation would forbid the making of a loan under the plan if, despite the borrower's statement to the contrary, it was really a purpose loan.

Section 221.3(a) of Regulation U permits a bank to rely on a statement by the borrower as to the purpose of a loan

> ". . . only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted; . . ."

and the regulation explains that

> ". . . to accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement."

The bank's manual of instructions to its employees with respect to this plan indicates precautions which are to be taken in attempting to ensure that the statement can be accepted in good faith. For example, if a check is to be mailed to the borrower in care of a broker or dealer, a purpose statement may be required from the latter. Delivery to the bank as collateral of a certificate dated shortly before the loan application would indicate the need for further inquiry. Repeated loan applications with certificates dated subsequent to prior loans would also suggest the possibility of a violation.

Although these precautions are useful and demonstrate the effort Merchants has made to bring the plan into conformity with the regulation, the Board does not believe it would be feasible, under the circumstances described, for the circumstances surrounding each loan and each borrower to be adequately known to the loan officer so that the officer could become aware of circumstances that might indicate a need for further investigation. While no precautions can completely eliminate error or evasion, the Board does not believe there is any satisfactory substitute for a face-to-face meeting between borrower and lending officer in developing information as to the purpose of a

loan. The regulation makes the officer responsible for determining the purpose of a loan, and it is difficult to see how he can discharge this responsibility, particularly in a routine case, without an opportunity to question the customer. In addition, a customer relationship, or the possibility that such a relationship may arise in the future, tends to put both customer and loan officer on a more realistic footing in respect to Regulation U.

While it is true that not all stock-secured loans involve personal interviews between borrowers and loan officers, or a customer relationship, these do obtain in the normal case. Loans made by mail under the plan put into operation by Merchants would tend to create a new class of stock-secured loan, to be made in relatively small amount for each loan, and potentially made in large numbers, so that the absence of these safeguards would be especially likely to result in the making of "purpose" loans that exceeded the permissible amount. Accordingly, the Board does not believe that a purpose statement submitted by mail in connection with a plan of this kind can satisfy the requirements of section 221.3(a).

One further difficulty remains to be discussed. In 1962 Federal Reserve Bulletin 690, the Board held that certain loans to be made by a bank against stock of American Telephone and Telegraph Company, although earmarked for "living expenses", must be considered to be purpose loans where the borrower was simultaneously purchasing additional shares under an employee stock purpose plan;* and the loans were to be geared to the amount of the monthly installment payment required. The Board pointed out that payroll deductions to finance purchases under the plan could be as high as 38 per cent of base pay, and a larger percentage of "take-home pay", and that deductions of this magnitude are in excess of the savings rate of many employees.

It may be asked whether this interpretation applies to loans made by Merchants under the present plan, if the borrower is simultaneously purchasing mutual fund shares under a periodic purchase plan, regardless of the use he may make of actual proceeds of the loan. The Board believes that the principle of the interpretation just discussed would apply where a purchaser is obviously buying more stock than he can carry out of current income, or where loan disbursements are geared to payments under such a purchase plan, and that in such cases, the lending bank should treat the loan as a regulated loan.

Since information normally obtained by lending officers would reveal whether the borrower was purchasing stock under such a plan, and whether the purchases were disproportionate to the borrower's income and other expenditures, it should not be difficult for the officer to make a judgment on this point. The existence of this question, however,

*Should have read stock purchase plan.

provides an additional reason why a personal interview is advisable in the case of a loan against mutual fund shares, if the bank is to satisfy itself that the loan is not a purpose loan and subject to the regulation.

A copy of this letter is enclosed for the use of Merchants. The substance of the letter will be published shortly in the Federal Register and the Federal Reserve Bulletin.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure

Item No. 3
3/10/65

S-1945

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 10, 1965.

Dear Sir:

The Board of Governors has been asked to consider whether the appointment by a State member bank of an agent to sell the bank's money orders, at a location other than the premises of the bank, constitutes the establishment of a branch office.

Section 5155 of the Revised Statutes (12 U.S.C. 36), which is also applicable to State member banks, defines the term "branch" as including "any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks paid, or money lent." The basic question is whether the sale of a bank's money orders by an agent amounts to the receipt of "deposits" at a "branch place of business" within the meaning of this statute.

Money orders are classified as deposits for certain purposes. However, they bear a strong resemblance to traveler's checks that are issued by banks and sold off premises. In both cases, the purchaser does not intend to establish a deposit account in the bank, although a liability on the bank's part is created. Even though they result in a deposit liability, the Board is of the opinion that the issuance of a bank's money orders by an authorized agent does not involve the receipt of deposits at a "branch place of business" and accordingly does not require the Board's permission to establish a branch.

Banks engaging in this practice should, of course, exercise the utmost discretion in choosing agents to sell the bank's money orders. It has been suggested that the agents be bonded, their authority be limited, and proceeds of the sales be remitted daily. Also the bank's blanket bond might be amended to provide protection if the present provisions are inadequate.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL
FEDERAL RESERVE BANKS.