

Minutes for March 15, 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

WM

Gov. Robertson

R

Gov. Balderston

CSB

Gov. Shepardson

SPS

Gov. Mitchell

JM

Gov. Daane

DA

Minutes of the Board of Governors of the Federal Reserve System on Monday, March 15, 1965. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Noyes, Adviser to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Johnson, Director, Division of Personnel Administration
Mr. Kakalec, Controller
Mr. Schwartz, Director, Division of Data Processing
Mr. Hexter, Assistant General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Koch, Associate Director, Division of Research and Statistics
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Smith, Assistant Director, Division of Examinations
Mr. Thompson, Assistant Director, Division of Examinations
Mr. Langham, Assistant Director, Division of Data Processing
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Sanders, Attorney, Legal Division
Mr. Egertson, Supervisory Review Examiner, Division of Examinations
Messrs. Lyon and Rumbarger, Review Examiners, Division of Examinations
Mr. Veenstra, Chief, Financial Statistics Section, Division of Data Processing

3/15/65

-2-

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

	<u>Item No.</u>
Letter to the Presidents of all Federal Reserve Banks stating that Reserve Banks may, if they wish, discontinue transfer of coin in the one cent denomination from Mint-sealed bags to Reserve Bank bags.	1
Letter to the Chairman of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations regarding the status of plans for eliminating sort of unfit Federal Reserve notes by Bank of issue and for local destruction of unfit Federal Reserve notes.	2
Letter to the Under Secretary of the Treasury for Monetary Affairs regarding the possibility of a conference to be attended by representatives of the Treasury Department, the Bureau of the Mint, the Board, and the Federal Reserve Banks to discuss development of better measures of future coin needs.	3

The draft of Item No. 3 had called for attendance at the proposed conference by one or more representatives from each Federal Reserve Bank. During discussion the view was expressed that such Reserve Bank representation would result in a body so large as to be unwieldy. Accordingly, the letter in the form transmitted was in terms that contemplated more limited Reserve Bank representation, with the thought that the views of the Treasury would be taken into account before a committee was organized.

Large denomination Federal Reserve notes (Item No. 4). There had been distributed a memorandum from Mr. Farrell dated March 11, 1965,

3/15/65

-3-

regarding a question raised by President Scanlon of the Federal Reserve Bank of Chicago as to the continued availability of Federal Reserve notes in denominations of \$500 and \$1,000. No new Federal Reserve notes above the \$100 denomination had been printed since 1945. In 1964 the Treasury Department asked that the Reserve Banks discontinue the issuance of notes above the \$100 denomination, but subsequently the Treasury indicated that it wished to study the matter further before such a policy was put into effect. The Chicago Reserve Bank had about exhausted its supply of \$500 notes, and to meet a continued demand had had to buy \$2,700,000 of them from the New York Reserve Bank. President Scanlon advocated that the \$500 and \$1,000 notes continue to be made available (presumably with resumption of printing of such denominations); or, alternatively, that any decision to discontinue issuance of such notes be on a System basis rather than by run-off at the various Reserve Banks. Under the run-off procedure some Reserve Banks would become unable to fill customer requests while other Banks still could do so, and he believed that criticism of the System would result.

Mr. Farrell's memorandum noted that a decision to resume printing \$500 and \$1,000 notes of individual Reserve Banks would be at variance with the decision of the Board in 1945 to discontinue further printing of notes above \$100; the authorization by the Board in 1959 of destruction of all notes of \$500 and over then held in Washington; the request by the Treasury in 1964 (later rescinded) that issuance of currency

3/15/65

-4-

in denominations higher than \$100 be discontinued; and recent expressions by members of the Board in favor of a single issue of Federal Reserve notes. The memorandum included a table indicating that Reserve Bank supplies of the \$500 and \$1,000 notes were uneven, some Banks having only a few notes while the New York and Boston Banks had relatively large stocks. The history of the use of the larger denomination notes was outlined, including the arising of suspicion that large denomination notes were used for tax evasion and black market activities, along with views that had been expressed that, if issuance of such notes were discontinued, the possibility of public uncertainties should be allayed by assurances that notes outstanding were not being called for redemption. The memorandum concluded with a proposal that the Board consider addressing a letter to the Secretary of the Treasury reviewing recent developments and suggesting that the Board and the Treasury jointly announce that issuance of Federal Reserve notes in denominations above \$100 would be discontinued, although such notes now outstanding would be allowed to remain in circulation until turned in to a Reserve Bank in the normal course of business. The change in practice would be explained in terms of lack of justification of the expense of new printing to replenish stocks of higher denomination notes that were becoming exhausted. A draft of letter in such terms was attached to the memorandum.

After summary comments by Mr. Farrell, the discussion turned principally to the question of reviewing any indications that might be

3/15/65

-5-

available regarding the degree to which large denomination notes were used for hoarding, tax evasion, or similar purposes. Views were expressed that since it appeared that possible illegitimate uses of large denomination notes were the more persuasive reason for discontinuing issuance rather than the cost of new printing, it might be well to call in outstanding notes as well as to discontinue issuing new ones.

There was unanimous agreement with a suggestion that action on the question raised by President Scanlon be tabled pending an inquiry of the Presidents of the Federal Reserve Banks as to any information they might have bearing upon the use of large denomination notes and as to their views regarding calling in outstanding notes of high denomination for redemption as well as discontinuing issuance of new notes. A copy of the letter sent to the Presidents is attached as Item No. 4.

During the preceding discussion the following entered the room:

Mr. Young, Adviser to the Board and Director,
Division of International Finance
Mr. Holland, Associate Director, Division of
Research and Statistics
Mr. Partee, Adviser, Division of Research and
Statistics

Administrative Procedure Act requirements (Item No. 5). There had been distributed a memorandum dated March 11, 1965, from the Legal Division submitting for the Board's consideration a draft of reply to a letter of February 12, 1965, from Chairman Moss of the Foreign Operations and Government Information Subcommittee of the House Committee on Government Operations. Chairman Moss's letter presented a series of

3/15/65

-6-

questions relating to compliance with the public information requirements of the Administrative Procedure Act (section 3).

After comments by Mr. O'Connell, the reply was approved unanimously. A copy is attached as Item No. 5. The letter from Chairman Moss had requested that the staff of the Subcommittee be informed of the name of the person on the Board's staff who would serve as liaison in the event that, after receiving the Board's reply, the Subcommittee wished further information. It was understood that the Subcommittee would be informed by telephone that Mr. O'Connell had been so designated.

Mr. Johnson then withdrew from the meeting.

Certificates of deposit (Item No. 6). There had been distributed a draft of reply to a letter of February 23, 1965, in which Chairman Fascell of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations raised certain questions about the increased use of certificates of deposit by banks.

Discussion of the draft turned principally on the language that should be used to describe the potentiality of banking problems arising from excessive or unsound use of certificates of deposit. The tenor of comments indicated a feeling on the part of several members of the Board that the draft letter leaned too much toward minimizing the possibility of trouble. It was pointed out that much of the material in the letter had already been made available to the Chairman of the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations,

3/15/65

-7-

and it was expected that the material would also provide much of the basis for Chairman Martin's statement before that Subcommittee tomorrow. It was observed that it was proper to convey assurance that the Board, being aware that the spread of certificates of deposit might provide fertile ground for unsound practices, was exercising diligence to the best of its ability to keep abreast of developments. On the other hand, it would seem desirable also to recognize that one of the primary means of keeping informed of the practices of individual banks was through examinations, which were normally conducted only once a year, thus admitting the possibility that interim changes in management or policy might engender trouble. The staff pointed out that the member bank call reports, with computer screening to disclose changes in deposit structure that might be significant, provided another warning device -- and one that was available at more frequent intervals than examinations. Another source of information was the reports of changes in control of bank management required under legislation enacted in 1964. Various suggestions were offered for changes in the language of the draft that would meet the points mentioned.

Unanimous approval then was given to the letter to Chairman Fascell, with the understanding that it would be revised to include elements of the views expressed during the foregoing discussion. A copy of the letter in the form transmitted to Chairman Fascell is attached as Item No. 6.

3/15/65

-8-

Cincinnati Branch building. In a letter of February 25, 1965, to the Federal Reserve Bank of Cleveland the Board expressed the view that the site contemplated for a new building for the Cincinnati Branch, comprising about 58,000 square feet in the Cincinnati Core Redevelopment Area, would be inadequate. In pursuance of suggestions made by the Board concerning the possible acquisition of certain properties in addition to the site originally proposed, the Reserve Bank had provided information in telephone conversations with Mr. Farrell regarding circumstances under which the Bank might be able to acquire specified properties on Walnut Street and on Fifth Street adjacent to the primary site. These circumstances were the subject of preliminary discussion by the Board on March 12, 1965, and were described in a distributed memorandum from Mr. Farrell dated March 11.

At today's meeting Mr. Farrell reported further on conversations with the management of the Cleveland Bank. The Walnut Street property in question was in two parcels, one of which, constituting 5,000 square feet at the corner of Walnut and Fourth Streets, was now included in the redevelopment plans, which had not been the case originally. The City contemplated offering the property to a building and loan association, but the alternative had been suggested of allowing the Reserve Bank to purchase the property if it would agree to have constructed on it a building to be leased to a restaurant, the lease to terminate within 10 to 15 years at the Bank's option. It had developed from the March 12

3/15/65

-9-

discussion that the Board members present were disinclined to allow such a commitment for temporary use of the land, and Mr. Farrell had so indicated to the Cleveland Bank. The other parcel of Walnut Street property, containing about 15,000 square feet, was occupied by the Mercantile Library Building, which was not included in the redevelopment project. The price being asked for the property was \$2.3 million. Chairman Hall considered that \$1 million or \$1.5 million would be a more realistic price, and suggested that the property be appraised. The fee that had been mentioned for an appraisal was \$25,000, but Mr. Farrell felt that this was too high.

Mr. Farrell's report to the Board at today's meeting included comments on appraisal fees for other System properties, the effect of acquisition of the Mercantile Library property upon the over-all cost of the land being considered for a Branch site, the probable expense of wrecking existing structures and the effect of that expense on over-all land cost, and open space being planned by the City in the Core Renewal Program. In reply to an inquiry by a member of the Board, he indicated that greater problems would appear to be involved in acquisition of the property on Fifth Street that had been mentioned as a possible extension of the Branch site. The indications were that it was available for purchase by the Reserve Bank only upon agreement to erect on it buildings to be occupied by small stores.

At the conclusion of the discussion a general view was expressed against any commitment for temporary use of property to be acquired,

3/15/65

-10-

especially in terms of erecting buildings for lease, and in favor of arranging for an appraisal of the Mercantile Library property for a fee in the neighborhood of \$10,000.

Mr. Daniels then withdrew from the meeting and Mr. Kenyon, Assistant Secretary, entered the room.

Call report forms (Item No. 7). There had been distributed a memorandum dated March 10, 1965, from the Division of Data Processing attaching a draft letter to transmit to the Federal Reserve Banks the forms proposed for use in the spring call upon State member banks for condition reports. The proposed form, which the Federal Deposit Insurance Corporation also intended to use, was in the abbreviated style used at spring and fall call dates since the fall of 1963. It appeared probable that the Comptroller of the Currency would continue to use the short form of report used for national banks at recent call dates. Although the national bank form thus was likely to be incompatible with those for State member banks and nonmember insured banks, no reconciliation slip-sheet was being proposed for the spring call because the value of the data did not appear to be worth the effort needed to achieve compatibility.

The memorandum noted that efforts to renew negotiations on the uniform condition report form and procedure proposed in the Board's letter of December 11, 1964, to other bank supervisory authorities had thus far been unsuccessful. Representatives of the Federal Deposit Insurance Corporation had expressed reluctance to discuss the matter with the State

3/15/65

-11-

bank supervisors at this time, although the door had been left open for discussions after the end of March that possibly could lead to agreement in time for the June call. The response of the Comptroller of the Currency to the Board's letter had stated that his staff would study the proposals and advise the Board when the study was completed.

Mr. Holland commented that after the March 10 memorandum was distributed there had been indications that the Federal Deposit Insurance Corporation might propose the use of a slipsheet that would elicit from banks information on certificates of deposit, probably including some size breakdown. The Board's staff would be inclined to support this. Also, individual State bank supervisors had made informal inquiries as to the possibility of agreement being reached on a uniform report, and the meeting of officers of the National Association of Supervisors of State Banks in Washington later this month might present an opportunity to advance this cause.

The ensuing discussion indicated an interest on the part of the members of the Board in reviewing the terms of the proposed uniform report and procedure, and in the possibility of informal discussion with the State bank supervisors, and it was understood that copies of the Board's letter of December 11, 1964, with its enclosures, would be re-distributed.

The letter transmitting to the Federal Reserve Banks the forms to be used for the spring call was then approved unanimously. A copy of the letter is attached as Item No. 7.

3/15/65

-12-

Messrs. Schwartz, Partee, Langham, and Veenstra then withdrew from the meeting.

Applications of First Virginia Corporation. There had been distributed memoranda dated February 26, 1965, from the Division of Examinations, with other pertinent papers, relating to the applications of The First Virginia Corporation, Arlington, Virginia, for permission to acquire 80 per cent or more of the voting shares of Bank of Chesapeake, Chesapeake, Virginia, and of Peoples Bank of Radford, Radford, Virginia. The Division recommended approval of both applications.

Mr. Thompson commented in supplementation of the material that had been distributed regarding the application to acquire Bank of Chesapeake, after which the application was approved. Governor Robertson abstained, indicating that he had not been able to review the distributed material due to other commitments but did not wish action deferred on that account.

Mr. Thompson then summarized the circumstances of the application to acquire Peoples Bank of Radford, following which the application was approved unanimously.

It was understood that orders and statements reflecting approval of the two applications would be drafted for the Board's consideration.

Messrs. Thompson, Sanders, Egertson, Lyon, and Rumbarger then withdrew from the meeting.

Inventory of Open Market Account portfolio. In a letter of March 10, 1965, Chairman Patman of the House Banking and Currency

3/15/65

-13-

Committee stated that he was "asking the Comptroller General of the United States to conduct a complete physical inventory of the investment portfolio of the Federal Open Market Committee . . . for the purpose of reporting on the status, location, and activity within the investment portfolio," and asked to be informed when the staff of the Comptroller General could undertake the inquiry.

At the conclusion of a preliminary discussion it was understood that a draft of reply would be prepared for the Board's consideration reflecting the tenor of views that had been expressed.

Study of quality of credit. At the instance of Chairman Martin there was a brief discussion of the possibility of rendering monetary or personnel assistance to the National Bureau of Economic Research in carrying forward certain procedures and techniques for appraising the quality of credit. Members of the staff expressed their understanding of what was embodied in the National Bureau approach; some reservations were indicated as to how productive such an approach might be, but the possibility of potentially constructive results was also indicated. Reference was made to work being done by members of the Board's research organization along experimental lines different from those envisaged by the National Bureau, and a view was expressed that the staff efforts should proceed vigorously in any event. The discussion concluded with an understanding that representatives of the Board's Research Division would explore further with representatives of the National Bureau the project contemplated by the Bureau.

3/15/65

-14-

The meeting then adjourned.

Secretary's Notes: Pursuant to previous actions of the Board relating to individual components of the legislative program to be submitted to the Congress early in 1965, letters transmitting the several legislative proposals were transmitted to the Chairmen of the appropriate Congressional Committees on March 15, 1965. Copies of the letters to the Senate Committee Chairmen are attached as Items 8 through 13; similar letters were transmitted to the Chairmen of the appropriate House Committees.

Governor Shepardson today approved on behalf of the Board the following items:

Memorandum from the Division of Personnel Administration dated March 12, 1965, recommending the payment of a consultant fee of \$200 at the end of 1965 and at the end of each year thereafter to Dr. Frederic D. Chapman for special consultations and advice rendered by him in connection with the Board's medical program for its employees.

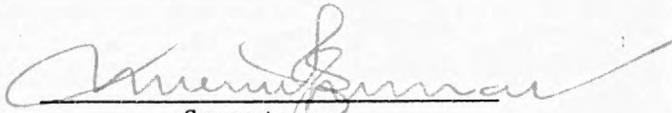
Memoranda recommending the following actions relating to the Board's staff:

Appointment

Lynda Fein as Clerk-Typist, Division of Research and Statistics, with basic annual salary at the rate of \$3,680, effective the date of entrance upon duty.

Reemployment following maternity leave

Daviette Hill Stansbury as Digital Computer Programmer, Division of Data Processing, with annual salary at the rate of \$4,325 (half-time basis), effective March 16, 1965.


Secretary

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

Item No. 1
3/15/65
S-1948



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 15, 1965.

Dear Sir:

The Board's letter of August 13, 1964, requested the Reserve Banks to adopt certain procedures in their coin operations which, it believed, should be continued until such time as the Secretary of the Treasury determined that adequate supplies of coin were available and resumed the practice of placing the year of mintage on coins.

In view of the improvement in the supply of coin, especially in the one cent denomination, your Bank was recently asked whether the rebagging of pennies could now be discontinued without hurting the supply. All but three of the Federal Reserve Banks replied in the affirmative.

The Director of the Mint has instructed the Mints to discontinue placing the specific designation "Philadelphia" or "Denver" on bags of coin and informed them that the Reserve Banks may resume paying out one cent coins in Mint bags.

The Board believes that if the Reserve Banks resume paying out one cent coins in Mint bags, no incentive to additional hoarding by dealers or speculators will result so long as the 1964 Mint date is continued. Accordingly, your Bank may, if it wishes, discontinue the transfer of coin in the one cent denomination from Mint sealed bags to Reserve Bank bags.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

Item No. 2
3/15/65BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

March 15, 1965.



The Honorable Dante B. Fascell, Chairman,
Legal and Monetary Affairs Subcommittee of
the Committee on Government Operations,
House of Representatives,
Washington, D. C. 20515.

Dear Mr. Chairman:

This is in reply to your letter of February 23, 1965, in which you inquired as to the status of plans for (1) eliminating sort of unfit Federal Reserve notes by bank of issue and (2) local destruction of unfit Federal Reserve notes.

The last sentence of the third paragraph of section 16 of the Federal Reserve Act now provides that "Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction." H.R. 5305, introduced by Mr. Patman at the request of the Secretary of the Treasury, would change this provision to read that unfit notes "shall be canceled, destroyed, and accounted for under procedures prescribed and at locations designated by the Secretary of the Treasury." This would, of course, permit local destruction.

H.R. 5305 would also add another sentence to section 16, as follows: "Upon destruction of such notes, credit with respect thereto shall be apportioned among the twelve Federal Reserve banks as determined by the Board of Governors of the Federal Reserve System." This would eliminate the need for sorting unfit notes, since the purpose of the sort has been to credit the bank of issue with the amount of the notes to be destroyed.

The Board favors the proposed legislation and hopes that action on H.R. 5305 will be taken promptly.

Sincerely yours,
(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Item No. 3
3/15/65



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

March 16, 1965.

The Honorable Frederick L. Deming,
Under Secretary of the Treasury
for Monetary Affairs,
Department of the Treasury,
Washington, D. C. 20220.

Dear Fred:

The Board was gratified to note that coin received by the Reserve Banks from circulation during February continued the upward trend begun in the previous month, and that this was the first time since before 1963 that February receipts were above those for January. This experience would seem to indicate that the massive production program of the Treasury is beginning to make substantial progress in abating the coin shortage, and that it would be appropriate at this time to give consideration to means for developing better measures of future coin needs.

In her letter of January 14, 1965, Miss Adams said that it would be helpful to the Bureau of the Mint if each of the Federal Reserve Banks and Branches could formulate an estimate of their coinage needs for the fiscal year 1966, and in the meeting which Mr. Wallace and she had with the Board and the Reserve Bank Presidents on February 2, 1965, the possibility of estimating future requirements and of obtaining inventory reports from member banks was explored further. Although the views of the Presidents indicated a strong feeling that no significant data along these lines could be obtained at this time, the general need for better data on coinage requirements is fully recognized. The problem seems to be in the nature of the steps that might be taken to improve the reporting system and the timing of such steps.

It is understood that, in discussions you and Mr. Wallace have had with Mr. Farrell of the Board's staff, the suggestion has been made that a conference attended by representatives of the Treasury, the Bureau of the Mint, and the Board, and by representatives from the Federal Reserve Banks knowledgeable in the coin problem might be helpful in developing a better data collecting program. The Board concurs in this view and would be pleased to arrange for such a conference at the convenience of the Treasury.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

The Honorable Frederick L. Deming -2-

The Board also feels, however, that the benefits of such a conference would be maximized if the Reserve Banks could be furnished in advance with an agenda or other indications of the matters to be discussed. Any thoughts that you and your associates may have in this regard would be appreciated.

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. 4
3/15/65



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD
March 17, 1965.

Dear Sir:

Enclosed is a memorandum dated March 11, 1965, concerning a Proposal by President Scanlon of the Federal Reserve Bank of Chicago that \$500 and \$1,000 Federal Reserve notes continue to be made available; or, alternatively, that any decision to discontinue payments of such notes be on a System basis rather than by "run-off at the various Reserve Banks." Attached to the memorandum is a draft of a proposed letter to the Secretary of the Treasury suggesting that payments of Federal Reserve notes above the \$100 denomination be discontinued, and that the Board and the Treasury issue a joint statement announcing this change in policy and the reasons for it.

The Board has given some consideration to this proposal but, before deciding on a course of action, it would appreciate receiving your comments and discussing the subject at a joint meeting with the Presidents. In particular the Board would like to have your comments as to:

- (a) The purpose for which your member banks may be requesting sizable amounts of \$500 and \$1,000 notes, if such is the case. Some indication with respect to the use of such notes may already be available at your Bank from the information shown on Treasury Form TCR-1, or it may be desirable to discuss the matter with the member banks concerned.
- (b) Whether there are indications of significant use of such notes for purposes not in the national interest.
- (c) What your feelings are, if there is an affirmative answer to item (b) above, as to the desirability of taking steps to call in for redemption all of the higher denomination notes now outstanding, as well as discontinuing any further payments of such notes.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

March 15, 1965.



The Honorable John E. Moss, Chairman,
Foreign Operations and Government Information
Subcommittee of the Committee on Government
Operations,
U. S. House of Representatives,
Washington, D. C. 20515

Dear Mr. Chairman:

This is in response to your letter dated February 12, 1965, advising that the Foreign Operations and Government Information Subcommittee is in the process of determining the extent to which Federal departments and agencies are making information available to the public pursuant to Section 3 of the Administrative Procedure Act (5 U.S.C. 1002). In order to evaluate the effect of Section 3 of the Act on the extent to which information has been made available by departments and agencies, you have asked that the Board respond to a series of questions set forth in your February 12 letter.

The Board's responses to your questions are set forth below, each immediately following the numbered question or series of questions to which it relates.

1. Generally, to what functions of your agency does 5 U.S.C. 1002 apply? Are there any divisions, bureaus, branches or other constituent units of your agency to which the Section does not apply?

The Board construes the provisions of 5 U.S.C. 1002 (hereinafter "Section 3 of the Act" [Administrative Procedure Act]) as applying to the entire range of its functions, which relate to credit and monetary policy determinations and to bank supervision and regulation.

There are no divisions, bureaus, branches or other constituent units of the Board to which Section 3 of the Act does not apply.

2. In what official or unofficial publication, and at what intervals, does your agency publish:

a. Descriptions of its central and field organization (see Section 3(a)(1) of the APA);

b. Statements of the general course and method by which its functions are channeled and determined (see Section 3(a)(2) of statute);

A description of the Board's organization and statements of the general course and method by which the Board's functions are channeled and determined are set forth in the Board's Rules of Organization and Procedure, publication of which is hereafter discussed, and are generally described in the United States Government Organization Manual, the official organization handbook of the Federal Government. There is not any predetermined interval at which the aforesaid description and statements are published by the Board. Broadly stated, pursuant to the requirements of Section 3 of the Act for current publication, the Board effects publication of Section 3(a)(1) material as follows: At such times as there occur changes in the general course and method by which the Board's functions are channeled and determined, including the nature and requirements of all formal or informal procedures, forms, and outstanding instructions, these changes are published in the Federal Register as amendments to the particular rule affected. As these amendments cumulatively represent a major revision in the Board's rule, the total of such amendments is published in the Federal Register as a revision to the rule. Thus, specific amendments to the Board's Rules of Organization and Procedure were published in the Federal Register at various intervals from 1946 through 1961. Effective December 15, 1961, the Rules of Organization and Procedure were wholly revised to include the amendments previously made and published, and also to change certain procedural provisions to reflect more clearly and accurately than current practices. The revised Rules were published in the Federal Register.

As revised, the Board's Rules of Organization and Procedure are divided into four separate rules, as follows:

(1) Rules of Organization,

(2) Rules Regarding Information, Submittals,

and Requests,

(3) Rules of Procedure, and

(4) Rules of Practice for Formal Hearings.

Rules (2), (3), and (4) above, currently appear, respectively, as Parts 261, 262, and 263 of Title 12, Code of Federal Regulations. The Rules of Organization, Rule (1) above, setting forth the Board's composition and location, identifying the makeup of its organization, and setting forth briefly the nature of the Board's functions, are published in the United States Government Organization Manual, the official organization handbook of the Federal Government. The Rules of Organization and Procedure are also available in pamphlet form at the Board's office or through the 12 Federal Reserve Banks. Amendments in these Rules occurring subsequent to the last-mentioned major revision have been published in the Federal Register and are reflected in appropriate provisions of the Code of Federal Regulations and the Government Organization Manual as revised June 1, 1964.

2.c. Substantive rules adopted as authorized by law (see Section 3(a)(3) of statute);

As applied to the Board, "substantive rules adopted as authorized by law" are represented almost exclusively by the Board's Regulations, as to which the Board follows the rule making procedures set forth in Section 4 of the Act as to giving notice of published rule making, affording interested persons an opportunity to participate in the rule making function, and the giving of required prior notice of the effective date of such rule. Once adopted, Regulations are published in the Federal Register and, in due course, appear in the Code of Federal Regulations. They also are published in pamphlet form available to the public. Adopted or amended Regulations also appear as promptly as possible following Board action in the Board's Federal Reserve Bulletin, a monthly publication. Promulgation of a new Regulation or an amendment to an existing Regulation is at times accompanied by the issuance of a press release explaining the nature and purpose of the Board's action. Finally, a record of Board actions in respect to promulgation of new Regulations or amendments of existing Regulations is contained in the Board's Annual Report transmitted to the Speaker of the House of Representatives pursuant to the requirements of Section 10 of the Federal Reserve Act (12 U.S.C. 247).

2.d. Statements of general policy or interpretations formulated and adopted by the agency for the guidance of the public (see Section 3(a)(3) of statute); and

Statements of general policy or interpretations formulated and adopted by the Board for the guidance of the public are published

The Honorable John E. Moss

-4-

initially in the Federal Register and later in the Code of Federal Regulations. Federal Register publication occurs as soon after Board action as practicable. The fact and content of Board interpretations, rules, and certain policy statements receive further public dissemination by appearance in the Board's Federal Reserve Bulletin and by publication in printed loose-leaf form in a volume of Published Interpretations of the Board. The Published Interpretations were originally compiled and published as of January 1, 1961, and contained the full text of then currently effective interpretations and rulings issued by the Board since October 1, 1937, as well as digests of certain additional interpretations and rulings published before that date. The volume of Published Interpretations has been kept current by means of supplements issued at year-end 1961 and 1962, and most recently by a supplement issued in July 1964 which included published interpretations, rulings, and related actions of the Board through March 31, 1964.

2.e. Rules addressed to and served upon named persons in accordance with law (see Section 3(a)(3) of statute)?

As a general rule, the Board does not publish in any official or unofficial publication "rules addressed to and served upon named persons in accordance with law". Section 3(a)(3) of the Act exempts such rules from the requirement of separate statement and current publication. The Board's reliance on this exemption, is premised upon a judgment that publication of such rules might be detrimental to a particular bank or to individuals concerned.

3. Please describe the manner in which your agency publishes, or, in accordance with published rule, makes available to public inspection, all final and interim opinions or orders in the adjudication of cases, pursuant to Section 3(b) of the APA or other authority.

In its adjudication of cases the Board does not utilize a procedure involving interim or tentative opinions, decisions, or orders. As to final orders of the Board, the manner in which these are published differs with the nature of the adjudication, the following examples being generally representative of the methods of publication employed. Your attention is directed to the fact that the term "adjudication of cases", as applied to the Board's functions, relates almost exclusively to Board process respecting the grant, denial, renewal, withdrawal, limitation, extension, or modification of a license or similar permission.

Pursuant to section 3(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(a)), the Board's prior approval must be given to the formation of a bank holding company and to actions proposed by an established bank holding company that would result in the expansion of its holding company system. Section 18(c) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1828(c)), requires the Board's prior written consent to certain bank mergers, consolidations, assets acquisitions, or assumptions of liabilities. Board action, either of approval or denial, on an application filed pursuant to either of the above provisions of law is published in the following manner: Following Board action on an application, there is issued a press release announcing the action, accompanied by a copy of the Board's order and statement in support thereof. If there are dissenting statements of individual Board members, copies of the dissenting statements accompany the press release, Board order, and statement. In each case the order is published in the Federal Register. The published order is accompanied by the statement that copies of the Board's statement, and any dissenting statements, are on file at the Office of the Federal Register, and are available at either the Board's office or the Federal Reserve Bank in the district where the applicant is located. The materials accompanying the aforementioned press release are published also in the Board's monthly Bulletin.

In respect to certain applications, public hearings are conducted by hearing examiners selected and designated by the Civil Service Commission. In such cases the hearing examiner's Report and Recommended Decision, filed with the Board prior to the Board's final action on the application, is also distributed to the public and published in the Federal Reserve Bulletin. It should be noted that the monthly issues of the Bulletin are published in paperback form and, subsequent to year-end, are bound in a single volume. These bound volumes are numbered consecutively, identified by date, and are made available to the public. Board actions in regard to applications having unusual significance or interest are also summarized or commented upon in the Board's Annual Report.

Additional selected examples of applications received whereby Board approval is requested are applications (1) for membership in the Federal Reserve System pursuant to section 9 of the Federal Reserve Act (12 U.S.C. 321); (2) for withdrawal from membership in the System (12 U.S.C. 328); (3) for the establishment of a domestic branch by a State member bank pursuant to section 9 of the Federal Reserve Act (12 U.S.C. 321); (4) to carry reduced reserves pursuant to section 19 of the Federal Reserve Act (12 U.S.C. 462);

The Honorable John E. Moss

-6-

(5) for the establishment of an overseas branch pursuant to section 25 of the Federal Reserve Act (12 U.S.C. 601); (6) for the organization of, or investment in, a corporation doing foreign banking pursuant to sections 25 or 25(a) of the Federal Reserve Act (12 U.S.C. 601 and 611); and (7) for a general voting permit pursuant to section 5144, Revised Statutes (12 U.S.C. 61).

In respect to the several types of applications mentioned above, the fact of the Board's receipt thereof and, in addition, the fact and nature of the Board's action thereon are made known to the public in a weekly H.2 list published by the Board. The H.2 list shows the names and locations of institutions involved, the date of receipt of an application and its nature, and the date and nature of the Board's action on the application. The Board also makes known through a published weekly K.3 list the fact and effective date of consummation of certain of the proposals first identified in an H.2 list.

4. In what types of cases does your agency refrain from publishing interim and final opinions or orders where, in the opinion of your agency, good cause requires they be held confidential, pursuant to Section 3(b) of the APA or other authority?

The only type of case adjudication as to which the Board would refrain from publishing notice of its action, either in the form of an order or otherwise, would be a proceeding conducted pursuant to Section 30 of the Banking Act of 1933 (12 U.S.C. 77) for the removal of directors and/or officers of State member banks. Section 30 expressly forbids disclosure to the public of the Board's order or of the findings of fact upon which such order is based.

5. In what circumstances are unpublished opinions and orders cited or used as precedents in other proceedings?

There have been no proceedings in which the Board has had occasion to cite or use as a precedent unpublished opinions and orders relating to an earlier proceeding. It is conceivable, however, that a need for such citation or use might arise. For example, in a Section 30 adjudication (see answer to Question 4., supra) facts that might be in issue in a pending proceeding could parallel in major respects facts that had been the subject of a previous Section 30

The Honorable John E. Moss

-7-

adjudication by the Board. In such a case, the Board's action in the earlier case, reflected in an unpublished order, might reasonably be cited or used as a precedent in the later proceeding. In such a case, the respondent in the later proceeding would be given ample notice of the Board's intention to use its earlier action as a precedent, and would be afforded full opportunity to challenge the applicability of the precedent cited, or to otherwise argue against use of such precedent.

6. What is the procedure for making available to the general public the records and files, interpretations and legal opinions of your agency?

A general description of the procedures whereby certain of the Board's records such as interpretations, opinions, orders, and other materials are made known and available to the public has been given in answers to other questions. As to Board records and files generally, the same are made available to the general public pursuant to the Board's Rules Regarding Information, Submittals, and Requests (12 CFR 261), and the Board's Rules of Procedure (12 CFR 262). Briefly summarizing certain of the more salient provisions of these Rules, matters of official record are made available to persons properly and directly concerned through the Office of the Secretary. Under the Secretary's direction and supervision, the Records Section has responsibility for maintaining custody of and providing reference service to official records of the Board. Matters of official record such as published Board orders, statements, and interpretations are available for studying and copying in the Board's office during regular business hours. Also available for similar purposes are the administrative records of public proceedings or hearings conducted by the Board. Upon request, arrangements can be made for the reproduction at the Board's office of these public records.

Within the Board's Division of Administrative Services there is operated a Publications Services unit that has the responsibility of furnishing to the public Board publications and published information and data. The materials handled by Publications Services are made available either on specific request or through use of currently maintained mailing lists. Information as to available publications and published information, including the Federal Reserve Bulletin, the Board's Regulations, Rules of Organization and Procedure, and Published Interpretations, is set forth in the Federal Reserve Bulletin.

The Honorable John E. Moss -8-

Two members of the Board's official staff are assigned the responsibility of facilitating the furnishing to and interpretation for the press and the public matters of public interest occurring in the course of the Board's performance of its functions. Board members, members of the official staff, and other authorized employees daily transmit to the public through various communication media portions or summaries of and views on the Board's official records.

7. What limitations are placed upon the availability of records and files to the general public, either by statute, rule or practice?

The limitations which the Board has placed upon the availability to the general public of its records and files are set forth in the Board's Rules Regarding Information, Submittals, and Requests (12 CFR 261.2). The principal classes of records and files as to which public access is limited are as follows:

(1) Information covered by specific legal prohibition against disclosure. Thus, public disclosure of findings of fact and orders issued in proceedings for the removal of directors or officers of member banks is expressly forbidden by Section 30 of the Banking Act of 1933.

(2) Information with respect to the determination of credit and monetary policies in the national monetary field, premature disclosure of which could very well play into the hands of speculators or public groups with a resulting disruption of markets. Federal Reserve actions relating to discount rates, reserve requirements, margin requirements, and like matters have, in particular, a direct effect on financial markets.

(3) Confidential information obtained by the Board in the discharge of its supervisory function.

Authority for nondisclosure of the categories of information referred to above, and more fully described in the Board's Rules Regarding Information, Submittals, and Requests, is based upon the provisions of Section 3 of the Administrative Procedure Act which permit nonpublication and nondisclosure of any information to the extent that it involves functions requiring nondisclosure in the

The Honorable John E. Moss

-9-

public interest or matters which for good cause found are held confidential. In addition, as earlier mentioned, Section 30 of the Banking Act of 1933 expressly provides that the Board's order and findings of fact in any proceedings for the removal of directors or officers of member banks shall not be made public or disclosed to anyone except the director or officer involved and the directors of the bank involved. The Board of Governors is authorized by statute to make rules and regulations necessary to enable it effectively to perform its duties and functions or services (12 U.S.C. 248(i)). Except as provided by law, employees of the United States are prohibited by statute (18 U.S.C. 1905) from disclosing financial or business information regarding particular persons or institutions.

Pursuant to authority granted by statute, the Board has promulgated rules relating to the maintenance of the confidential character of System affairs. In respect to employees who are authorized to handle classified defense material, the Board has issued "Regulations Relating to the Safeguarding of Defense Information".

The foregoing summary reflects the limitations which have been placed by statute, rule, or practice on the availability to the general public of the Board's records and files.

8. In what circumstances are private parties dealing with your agency required in any manner to resort to organization or procedure not published in the Federal Register (see Section 3(a) of the APA)?

The Board believes that its procedures for making public its Rules of Organization and Procedure, including but not limited to publication of the same in the Federal Register, are calculated to apprise the public adequately of existing requirements in dealing with the Board. In no known circumstances have private parties dealing with the Board been required to resort to organization or procedure not published in the Federal Register pursuant to Section 3(a) of the Act. On the other hand, there have been numerous occasions when, in the interest of facilitating a course of action initiated by a private party dealing with the Board, the Board has excused failure to comply with published organizational or procedural rules.

9. In what types of cases has your agency refrained from publishing rules where there is involved any function of the United States requiring secrecy in the public interest, pursuant to Section 3(1) of the APA or other authority?

The Honorable John E. Moss

-10-

Applying to the word "cases" a broader meaning than that generally applied in the context of the provisions of the Act, the Board has refrained from publishing rules in regard principally to actions taken in the course of formulating and determining discount rates, reserve requirements, margin requirements, and similar actions calculated to have a direct effect on financial markets. The Board's action in refraining from publishing rules incident to the foregoing functions is taken pursuant to Section 3(1) of the Act.

10. In what circumstances has your agency refrained from publishing rules where there is involved any matter relating solely to internal agency management, pursuant to Section 3(2) of the APA or other authority?

The Board has followed what it has construed to be the intent of Section 3 of the Act in refraining from publishing rules of internal management and operation not affecting the members of the public to any extent. Rules relating to the organization of the Board's staff, the assignment and designation of staff responsibilities and functions, and general housekeeping functions, including budget procedures, are considered to be purely matters of internal management and operation, and thus to be exempt from the publication requirement of Section 3 of the Act.

11. What is your agency's definition of "official record" as used in Section 3(c) of the APA?

As related to the Board's functions, the term "official record" refers to and includes all materials in the Board's possession save those relating to the internal operation of the Board.

Pursuant to your request for two copies of every regulation, directive, order, or other document issued by the Board to implement Section 3 of the Act, two copies of the following documents are enclosed:

1. Board's Rules of Organization and Procedure,
2. Board's Regulations Relating to the Safeguarding of Defense Information,
3. Board's Rules Relating to the Maintenance of the Confidential Character of System Affairs, etc.

The Honorable John E. Moss

-11-

Many of the publications hereinbefore discussed exemplify the steps taken by the Board in implementing the directives of Section 3 of the Act. Most illustrative of this implementation are believed to be the following documents, published at or for the dates noted, two copies of which are enclosed: the Fiftieth Annual Report of the Board, covering operations for the year 1963; the February 1965 issue of the Federal Reserve Bulletin; a reprint from the December 1964 Federal Reserve Bulletin containing a list of all Federal Reserve Board publications; the Board's H.2 list reflecting applications received, or acted on by the Board during the week ended March 6, 1965; and the Board's K.3 list reflecting consummation of various proposals by State member banks as of the week ended March 6, 1965.

Should your Subcommittee desire other of the documents herein mentioned than those enclosed, upon request copies of such documents will be furnished.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 6
3/15/65

OFFICE OF THE CHAIRMAN

March 16, 1965.

Honorable Dante B. Fascell, Chairman,
Legal and Monetary Affairs Subcommittee
of the Committee on Government Operations,
House of Representatives,
Washington, D. C. 20515.

Dear Mr. Chairman:

Reference is made to your letter of February 23, 1965, regarding the increased use of Certificates of Deposit -- sometimes called CDs -- by banking institutions.

In some areas of the country CDs have long been a usual form of document banks have issued when they receive savings on deposit. Those CDs differed from ordinary savings deposits legally and technically, including the fact that they often were legally "negotiable" i.e., in form to permit easy legal transfer from one holder to another. But in their essential economic characteristics they were much the same as ordinary savings deposits represented by a "passbook" -- they were in relatively small amounts, and the depositor usually had other customer relations with the bank or was located near the bank. In other words, the funds represented by those CDs tended to be relatively stable, because it usually served the depositor's convenience or other self-interest to keep them with the bank; while the rate of interest was of some significance, it was not of paramount importance.

Many CDs still have these characteristics. However, in recent years some banks have issued large volumes of CDs in greatly different circumstances. In appearance and legal form these CDs are quite similar to those that have been used for many years as the rough equivalent of savings "passbooks". In economic effect, however, they are drastically different because they have tapped an essentially different source of funds. Whereas CDs formerly were issued principally to individuals and in relatively small amounts, the recent expansion of CDs has been principally in large denominations and to corporate and other large interest-sensitive purchasers. The rate of interest has become vitally important. The documents are not only legally "negotiable" but to an increasing degree are in practice marketable and marketed, that is, they are often traded impersonally and even issued originally on that basis. In short, a substantial portion of CDs now represent impersonal and volatile funds.

In view of the growing importance and changing economic characteristics of CDs, the Federal Reserve System made a survey of amounts outstanding at December 5, 1962, and for each of the two preceding year-ends. The results were published in the Federal Reserve Bulletin for April 1963 at p. 458. A copy is attached for convenient reference. For the 410 banks surveyed, CDs increased from just over \$1 billion at the end of 1960, and \$3.2 billion at the end of 1961 to \$6.2 billion at December 1962.

Honorable Dante B. Fascell

-2-

Since January 1, 1964, the Board has published weekly information on CDs outstanding at the so-called "weekly reporting member banks." This is a sample of about 350 member banks that give information each week on their financial position. This sample is slightly smaller than that in the earlier survey, and CDs for these reports are limited to those of \$100,000 denomination or larger. On March 3, 1965, these weekly reporting member banks had about \$13.9 billion of such CDs outstanding. This represented about 8% of the total deposits of these banks.

The new uses of CDs have offered new opportunities to some banks. They have enabled banks to acquire loans and investments they could not otherwise finance. But the more volatile CDs also involve new hazards. Ordinary prudence dictates that a bank should schedule its CDs to avoid undue concentrations of maturities; but this is only part of the story. A bank should also avoid having an undue proportion of its deposits in the volatile CDs. In most cases a bank should hold at least as much liquidity against volatile CDs as against demand deposits -- and in some instances it should hold more. Volatile CDs can expose a bank's assets to severe tests of liquidity and soundness, since such CDs increase the risk of the bank's having to sell or borrow on the assets.

CDs, whether the more volatile or the more stable variety, tend to represent high cost money. In order to earn a profit a bank using them must place the funds in relatively higher yielding loans and investments. A bank can easily fall into the trap of reaching for high cost funds through volatile CDs and then reaching for high yield -- and high risk -- assets. A bank's apparent ability to get funds readily by issuing volatile CDs can lull it into a false sense of security -- can cause it to mistake mere size of deposit totals for sound growth.

In order to avoid these pitfalls, a bank issuing volatile CDs, must have special skills that are not always found in every bank. The hazards are intensified if the bank is relatively small or is newly chartered. Such a bank may have a ready market for its CDs one day and none whatever the next; unless it has maintained proper liquidity and soundness in its assets, it cannot pay its volatile CDs as they fall due. These problems were reflected in the receiverships of San Francisco National Bank, San Francisco, California, and Brighton National Bank, Brighton, Colorado, on January 22, 1965.

The problems can be compounded if a bank markets volatile CDs through a broker, possibly paying an extra fee for obtaining the funds. Some banks have even loaned the funds so obtained to unknown borrowers suggested by the CD broker, who was also acting as loan broker.

Questions regarding the soundness of CD activity of individual banks require analysis of the assets, liabilities, capital, and management skills of such banks. This is the kind of analysis that examiners typically apply. It is a continuing responsibility of the examination departments of the Federal Reserve Banks that act as the field representatives of the Board in examining State member banks of the Federal Reserve System.

In most of the instances in which CDs have been abused, the practice has been symptomatic of generally unsound activity in the bank. In other words, the bank with CD problems has usually had other problems, including unsound lending practices.

A bank's executive officers, and particularly its board of directors, have the first and foremost responsibility for preventing or correcting unsound situations. As stockholders, as members of the community, and as possible defendants in litigation against them for negligence or misfeasance, they have much to gain from correction of unsound conditions and much to lose from unsound activities. In examining and supervising State member banks, the Reserve Banks and the Board endeavor to prevent banking problems by stressing the importance of sound practices, and the necessity for boards of directors to provide sound management for their banks.

When an examination shows unsound conditions in a State member bank, the Reserve Bank presents the facts to the executive officers and, if necessary, the directors. The purpose is to have the management of the bank recognize and carry out its responsibility to operate the bank soundly. Solution of CD problems in such cases usually requires solution of related problems. Besides avoiding further expansion of volatile CDs, the bank's management must stop making unsound loans, and do everything possible to collect or strengthen any such loans already made. To the fullest extent practicable, the bank must collect, sell, or borrow on loans where necessary to pay off maturing CDs. To date a few State member banks have had to absorb losses when their assets could not satisfactorily meet the test of being converted into cash to pay maturing CDs, and others may experience similar difficulties.

The Federal Reserve Board has authority to terminate a State member bank's membership in the Federal Reserve System and its deposit insurance for unsafe or unsound practices. It also may remove an officer or director of a State member bank for continued violation of law or continued unsafe or unsound practices. These are drastic remedies, and under the law can be invoked only by following carefully prescribed procedural safeguards. It best serves the public interest to use these sanctions only in extreme cases. Thus far it has not seemed appropriate to invoke them in any case involving CD problems in a State member bank.

In troublesome situations the Reserve Bank may examine the bank more frequently than once each calendar year, and may request interim progress reports from the management. A further useful check on the CD activity of banks is provided by quarterly reports of condition which are received and reviewed at the Reserve Banks. All of

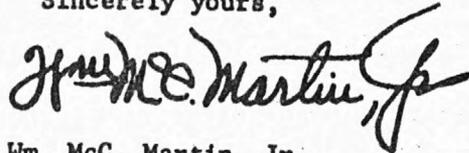
Honorable Dante B. Fascell

-4-

these tools have or can be employed by the System in dealing with and controlling existing and developing problems with respect to CDs. It also is believed that publicity in the general and financial Press, of the type furnished with your letter, has helped to emphasize to bankers and depositors the dangers inherent in the overexpansion of volatile deposits through the issuance of certificates of deposit and the investment of the funds in high-yield, high-risk loans, and that it will serve to supplement and strengthen the efforts of bank supervisors.

At this time the Board of Governors does not have any specific legislative proposals relating to CDs but does not wish to foreclose the possibility of later recommendations regarding the subject.

Sincerely yours,



Wm. McC. Martin, Jr.

Enclosure

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

Item No. 7
3/15/65



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 19, 1965.

Dear Sir:

The indicated number of copies of the following forms are being forwarded to your Bank under separate cover for use of State member banks and their affiliates in submitting reports as of the next call date. A copy of each form is attached.

Number of
copies

- Form FR 105 (Call No. 175), Report of Condition of State member banks.
- Form FR 105e (Revised February 1961), Publisher's copy of report of condition of State member banks.
- Form FR 105e-1 (Revised February 1961), Publisher's copy report of condition of State member banks.
- Form FR 220 (Revised March 1952), Report of affiliate or holding company affiliate.
- Form FR 220a (Revised March 1952), Publisher's copy of report of affiliate or holding company affiliate.

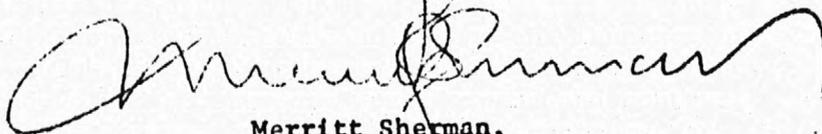
The forms are identical to those used for the October 1, 1964, call date and exclude the schedules on the reverse, except for the items required for deposit insurance assessment purposes and the affiliate schedule. The same form is being printed by the Federal Deposit Insurance Corporation for distribution to insured nonmember State banks.

-2-

The form to be distributed to national banks by the Comptroller of the Currency is expected to be the same as that used for the October 1, 1964, call date and thus will differ in several respects from the form being used by State banks. There are no plans to collect supplementary information from national banks for the purpose of reconciling these differences. Under these circumstances, it is not planned to make computer tabulations of the data in Washington, and it will therefore not be necessary to keypunch these reports.

For your information, discussions are in progress with the other Federal Bank Supervisory Agencies that may lead to collection of supplementary information on time certificates of deposit issued by State member banks--possibly in connection with the spring call. You will be advised promptly when final decisions are made.

Very truly yours,



Merritt Sherman,
Secretary.

Enclosures.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

921
Item No. 8
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable A. Willis Robertson, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

The Board of Governors again wishes to recommend legislation that would permit member banks of the Federal Reserve System to borrow from the Federal Reserve Banks on the security of any sound assets without paying a "penalty" rate of interest. This legislation would replace present provisions of the Federal Reserve Act that permit borrowings without a penalty interest rate only on the security of Government obligations or paper that meets certain outmoded "eligibility" requirements. These restrictive provisions should be amended so as to facilitate rather than penalize efforts by banks to meet the public's changing credit needs.

The original Federal Reserve Act authorized the Reserve Banks to discount only certain types of paper arising out of "actual" commercial or agricultural transactions, subject to specified maturity limitations. The concept underlying this limited authority was that the liquidity of commercial banks could be assured only if the loans made by them were short-term and self-liquidating in character. Related to this concept was the assumption that the pledging of such discounted paper by the Reserve Banks as security for the issuance of Federal Reserve notes would serve as the basis for an elastic currency; it was expected that the volume of currency would expand and contract directly in response to the varying credit needs of the economy, as reflected by the volume of short-term borrowing by commercial and agricultural enterprises.

The principle that Federal Reserve credit should be extended only on the basis of short-term, self-liquidating paper was departed from as early as 1916, during the First World War, when the law was amended to authorize the Reserve Banks to make 15-day advances to member banks, not only on the security of "eligible paper" but also on the security of direct obligations of the United States. A more significant departure occurred in 1932, when Congress authorized the Reserve Banks to make advances to member banks in exceptional and

unusual circumstances on any security satisfactory to the Reserve Banks, although at a penalty rate of interest. This authority, at first temporary, was made permanent in 1935, and it is no longer limited to exceptional and unusual circumstances, although such advances continue to carry a penalty rate of interest.

The concept that limitation of discounts to short-term, self-liquidating paper would serve automatically to regulate the volume of Federal Reserve notes in circulation has also been departed from by amendments to the law and has been refuted by experience. In 1932, Congress authorized the issuance of Federal Reserve notes on the security of Government obligations in addition to eligible paper and gold. This authority was originally of a temporary nature, but it was made permanent in 1945. The volume of Federal Reserve notes today fluctuates with the changing demands of the economy without regard to the nature of the paper offered as collateral for Federal Reserve credit or pledged as security for Federal Reserve notes.

Each of these legislative changes took place during a period of economic stress that served to make clear the inadequacy of the original framework for Federal Reserve credit extension. The credit needs of American businessmen, farmers, and consumers were evolving in many ways that could not be adequately handled by the old instrument of short-term, commercial-type paper; and the rapid growth of both private and Governmental economic activity generated credit requirements far in excess of those that could be supported by the relatively small volume of "eligible paper". For example, farmers today make much greater use of mechanized equipment; a modern combine represents a big investment, and requires longer-term financing. Another example is the entry of banks into consumer lending in response to credit needs created by the mass marketing of automobiles and other durable consumer goods. Banks are now making term loans to business, too, in substantial volume, partly in response to economic changes and partly in recognition that a two-year loan may be sounder than a 90-day loan made in the expectation of repeated renewals.

Despite changes in the character of paper held by commercial banks and the repeated and necessary departures from the original concept that discounts should be based only on short-term, self-liquidating paper, the law continues to impose unduly restrictive requirements as to the nature and maturity of the paper that may be discounted by the Reserve Banks or offered as security for advances by the Reserve Banks without payment of a penalty rate of interest.

For many years, it has been generally recognized that the concept of an elastic currency based on short-term, self-liquidating

paper is no longer in consonance with banking practice and the needs of the economy. It has long been apparent that the narrow requirements of the law regarding "eligible paper" serve no useful purpose and that it would be preferable to place emphasis on the soundness of the paper offered as security for advances and the appropriateness of the purposes for which member banks borrow. The one-year paper of many bank customers that is not now eligible for discount may be as satisfactory collateral as the 90-day notes of other customers. Moreover, the nature of the collateral provides no assurance that the borrowing bank will use the proceeds for an appropriate purpose.

As long as member banks hold a large enough volume of Government securities, they need not, of course, be particularly concerned as to the eligibility for discount with the Reserve Banks of customers' paper held by them. Since World War II, however, there has been a sharp net decline in the aggregate holdings of Government securities by member banks. If a continuing substantial increase in economic activity should cause banks further to reduce their holdings of Government securities in order to meet increased credit demands, many banks would be obliged to tender other kinds of collateral if they should seek to obtain Federal Reserve credit.

If such a situation should develop, the Reserve Banks could accept technically "ineligible" paper as collateral for advances to their member banks only under section 10(b) of the Federal Reserve Act at a rate of interest one-half of one per cent above the regular discount rate. However, the necessity for distinguishing between "eligible" and "ineligible" paper would give rise to cumbersome administrative procedures that are not warranted by the exigencies of current banking conditions. In order to avoid these problems, it would clearly be preferable to move in advance and to revise and up-date the law so as to eliminate the existing restrictions with respect to "eligible paper".

The Board of Governors and the Federal Reserve Banks believe that such a revision of the law would be desirable so that the Reserve Banks will always be in a position to perform promptly and efficiently one of their principal responsibilities - the extension of appropriate credit assistance to member banks to enable the latter to meet the legitimate credit needs of the economy.

Accordingly, the Board again urges that legislation of the kind here proposed be given favorable consideration by your Committee and by the Congress. A draft of the bill in the form previously proposed and as introduced in the last Congress is enclosed herewith, along with a section-by-section explanation and a document showing textual changes that would be made in present law.

Sincerely yours,

(Signed) Wm. McG. Martin, Jr.

Wm. McG. Martin, Jr.

Enclosures



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 9
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable A. Willis Robertson, Chairman,
Banking and Currency Committee,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

Section 5(d) of the Bank Holding Company Act of 1956 requires the Board of Governors, in its Annual Report to the Congress, to include any recommendations for changes in that Act which, in the opinion of the Board, would be desirable. After two years of experience in administering the Act, the Board, in a Special Report to the Congress dated May 7, 1958 (published in the Federal Reserve Bulletin for July 1958, beginning at page 776), recommended a number of amendments to the Act. In subsequent Annual Reports to Congress, these recommendations have been reiterated, with the exception of one (Item 15 in the 1958 Report) that became unnecessary upon enactment of the Bank Merger Act of 1960.

In the light of nearly nine years of experience, the Board again recommends amendment of the Holding Company Act and certain related provisions of law, substantially along the lines recommended in 1958, although with certain additional changes that appear desirable.

Enclosed is a draft of a bill that would implement the Board's recommendations for changes in the law. Some of the changes relate to significant and substantive matters; others would clarify the law or resolve relatively minor problems.

The principal changes that would be made by the bill are the following:

- adoption of a one-bank definition of "bank holding company" in lieu of the present two-bank definition;
- repeal of exemptions with respect to registered investment companies; companies engaged principally in agriculture; and charitable, religious, and educational organizations;

-2-

coverage of cases in which banks are controlled by employee-benefit trusts or by long-term testamentary or inter vivos trusts;

repeal of section 6 of the Act, relating to intrasystem loans and investments, with appropriate revision of section 23A of the Federal Reserve Act, limiting dealings between member banks and their affiliates; and

repeal of the "holding company affiliate" provisions of Federal law, enacted in 1933, that have been rendered unnecessary by the Bank Holding Company Act.

These and other substantive changes covered by the bill, as well as a number of changes of a technical nature, are discussed in the enclosed Explanatory Memorandum. Also enclosed is a "comparative draft" showing textual changes in existing law that would be made by the bill.

The Board strongly recommends favorable consideration of this legislation by your Committee and the Congress.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

927
Item No. 10
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable A. Willis Robertson,
Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

Since February 1962, the Federal Reserve Bank of New York has engaged in foreign currency operations on behalf of the System Open Market Account and under directions of the Federal Open Market Committee. These operations have been encouragingly successful in accomplishing their basic purposes, i.e., the avoidance of disorderly conditions in international exchange markets, the furtherance of monetary cooperation with central banks of other countries maintaining convertible currencies, the moderation of temporary imbalances in international payments, and, in net effect, the safeguarding of the value of the dollar in international exchange markets.

These operations have been implemented by the establishment of reciprocal credit balances or "swap" arrangements between the New York Reserve Bank and foreign central banks. The authorization and guidelines for foreign currency operations adopted by the Federal Open Market Committee require that the New York Reserve Bank instruct foreign central banks with which it maintains accounts regarding the investment of amounts in excess of minimum working balances in accordance with the provisions of section 14(e) of the Federal Reserve Act.

Under section 14(e), idle amounts held by the Reserve Bank in an account with a foreign bank may be invested in bills of exchange and acceptances that arise out of actual commercial transactions and have maturities of not more than 90 days, or they may be placed in an interest-bearing time account with the same or some other foreign bank. However, in certain instances there has been a scarcity of such paper for investment, time deposit facilities have not always been conveniently available, and, under present law, such idle funds could not be invested in obligations of foreign governments, such as foreign treasury bills. On the other hand, a foreign central bank having a balance or reciprocal credit or "swap" arrangement with the Federal Reserve Bank of New York may invest idle funds in its account with the Reserve Bank in interest-bearing United States securities.

The Honorable A. Willis Robertson -2-

The disadvantage in this respect under which a Reserve Bank must operate has handicapped the smooth operation of the foreign currency program. The situation would be remedied by an amendment to section 14(e) of the Federal Reserve Act that would specifically authorize a Federal Reserve Bank to buy and sell securities with maturities not exceeding 12 months that are issued or guaranteed by foreign governments.

The Board recommends the enactment of such an amendment to the law. A suggested draft of a bill for this purpose is enclosed.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

929
Item No. 11
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable A. Willis Robertson, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

In recent years, the responsibilities and tasks of the Board of Governors have substantially increased both in determining monetary and credit policies and in the field of bank supervision.

The efficient and expeditious performance of these important functions could be seriously impaired in the absence of authority on the part of the Board to delegate certain types of bank supervisory functions that now must be performed by the Board itself in all cases. For example, the Board must, under present law, pass upon each investment in bank premises by a member State bank if such investment would exceed the amount of its capital stock.

Other Federal regulatory agencies now have more or less unlimited authority to delegate their functions pursuant to provisions of statute or Reorganization Plans. The Board considers that the Federal Reserve Act should be amended to provide the Board with similar authority.

A draft of a bill for this purpose is enclosed. It would authorize delegation of the Board's functions to members or employees of the Board or to the Federal Reserve Banks, but would expressly preclude delegation of those functions relating to rulemaking and monetary and credit policies. Under the bill, the Chairman of the Board would assign responsibility for the performance of particular delegated functions. A provision requiring Board review of action taken at a delegated level, at the instance of any one member, would (1) assure any party adversely affected by such action of a means of administrative appeal and (2) provide the Board with an effective means for review and control of actions at the delegated level.

It would not be anticipated that the Board would delegate its more important functions. On the contrary, it is envisioned that only relatively minor functions would be delegated at the outset and that determinations whether to make further delegations would be made in the light of experience.

The Board urges that this proposal be given favorable consideration by your Committee and by the Congress.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

931

Item No. 12
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable A. Willis Robertson, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

The Board of Governors wishes to recommend certain amendments to the provisions of section 22(g) of the Federal Reserve Act regarding loans by member banks of the Federal Reserve System to their executive officers.

These provisions presently prohibit a member bank from making loans to any of its executive officers, except in an amount not exceeding \$2,500 and then only with the prior approval of a majority of the bank's board of directors. In addition, an executive officer is required to make a written report to his bank with respect to any loan obtained by him from any other bank.

The Board believes that these restrictions, first enacted in 1933, are unrealistically severe in the light of changed economic conditions and that they should be liberalized.

In 1956, in connection with the then proposed "Financial Institutions Act", the Board recommended that the \$2,500 exemption be increased to \$5,000. This change was included in that bill as it passed the Senate in 1957; and the bill would have also relieved executive officers from the burden of reporting borrowings from other banks where they would not exceed \$15,000 in the case of home mortgage loans or \$5,000 in the case of other loans. The Report of the President's Committee on Financial Institutions in April 1963 recognized the desirability of increasing the \$2,500 ceiling on the amount an executive officer may borrow from his bank.

The underlying purpose of restrictions on loans by member banks to their executive officers is unquestionably sound. However, the Board believes that some liberalization of these restrictions would not be contrary to the public interest. In addition to an

increase in the basic ceiling on exempted loans, the law should provide a special exemption with respect to mortgage loans covering the purchase of an executive officer's home.

Accordingly, the Board recommends (1) that an executive officer of a member bank be permitted to borrow from his own bank up to \$5,000, or, in the case of home mortgage loans, up to \$30,000; (2) that, in lieu of the present requirement for prior approval by the bank's board of directors with respect to exempted borrowings by an executive officer from his own bank, the officer be required to report any such borrowing to the board of directors; and (3) that reports as to borrowings from other banks be required only where they would exceed in the aggregate the amount an executive officer could borrow from his own bank. In connection with these changes, certain obsolete provisions of the law should be repealed.

To preclude favoritism, these changes should be accompanied by a requirement that any loan to a bank's executive officer shall be made on terms not more favorable than those extended to other borrowers.

There is enclosed a draft of a bill that would amend section 22(g) of the Federal Reserve Act along the lines above described. The Board urges favorable consideration of such a bill by your Committee and by the Congress.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

933

Item No. 13
3/15/65

OFFICE OF THE CHAIRMAN

March 15, 1965.

The Honorable James O. Eastland, Chairman,
Committee on the Judiciary,
United States Senate,
Washington, D. C. 20510

Dear Mr. Chairman:

Section 212 of the United States Criminal Code (18 U.S.C. 212) prohibits a member bank of the Federal Reserve System or a nonmember insured bank from making any loan to any examiner or assistant examiner who examines or has authority to examine such bank. Conversely, section 213 of the Code (18 U.S.C. 213) makes it a criminal offense for any examiner to obtain any loan from any member bank or nonmember insured bank examined by him.

While these provisions of law, designed to prevent conflicts of interest, are based upon sound principles, the Board believes that they unduly and unfairly place bank examiners at a serious disadvantage in the obtaining of financing for the purchase or construction of homes. Modification of the law to permit insured banks to make home mortgage loans to examiners up to some maximum amount prescribed by statute would not, in the Board's opinion, defeat or impair the accomplishment of the purposes of these provisions.

Accordingly, the Board recommends the introduction and enactment of appropriate amendments to the Criminal Code that would authorize an insured bank to make a home mortgage loan to an examiner up to an amount not exceeding \$30,000. A draft of a bill for this purpose is enclosed herewith.

While such a bill would make it possible for a bank examiner to obtain home mortgage financing from a bank that he has authority to examine or a bank that he may actually examine, it would be the Board's policy not to permit assignment of any examiner to participate in the examination of a bank with which he has a home mortgage loan outstanding.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure