Minutes for May 12, 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 _____

Gov. Maisel _____

Minutes of the Board of Governors of the Federal Reserve System on Wednesday, May 12, 1965. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Noyes, Adviser to the Board
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Hackley, General Counsel
Mr. Solomon, Director, Division of Examinations
Mr. Kelleher, Director, Division of Administrative Services
Mr. Kakalec, Controller
Mr. O'Connell, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Holland, Associate Director, Division of Research and Statistics
Mr. Sammons, Adviser, Division of International Finance
Mr. Goodman, Assistant Director, Division of Examinations
Mr. Leavitt, Assistant Director, Division of Examinations
Mrs. Semia, Technical Assistant, Office of the Secretary
Miss Hart and Mr. Via, Senior Attorneys, Legal Division
Messrs. Forrestal and Shuter, Attorneys, Legal Division
Mr. Smith, Senior Economist, Division of Research and Statistics
Messrs. Egertson and McClintock, Supervisory Review Examiners, Division of Examinations
Mr. Goodfellow, Review Examiner, Division of Examinations

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on May 10, 1965, of the rates on discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

Application of Marine Midland International (Item No. 1). There had been distributed a memorandum dated May 6, 1965, in which the Division of Examinations recommended approval of the application of Marine Midland International Corporation, New York, New York, for permission to purchase shares of Financiera Espanola de Inversiones, Madrid, Spain, at a cost of approximately $500,000. A draft of letter that would grant the requested permission was attached to the memorandum.

After a discussion during which Governor Robertson remarked that although it would be preferable in present circumstances for Edge Act corporations to use their funds in less-developed countries he would not vote adversely in this instance, the application was approved unanimously. A copy of the letter informing Marine Midland International of this decision is attached as Item No. 1.

Application of United California Bank (Items 2, 3, and 4). There had been distributed a draft of order and statement reflecting approval by the Board on April 22, 1965, of the application of United California Bank, Los Angeles, California, to merge with Bank of Ceres, Ceres, California. A dissenting statement by Governor Robertson also had been distributed.

Question was raised about accounting for all members of the Board in the record of votes contained in the order, inasmuch as Governor Maisel was now a member but had not yet taken office when the decision was reached on April 22. There was agreement that the order should state that Governor Maisel did not participate in this action.

The issuance of the order and statement was then authorized. Copies of the documents, as issued, are attached as Items 2 and 3. A copy of Governor Robertson's dissenting statement is attached as Item No. 4.

Messrs. Sammons, Goodman, Via, Egertson, and Goodfellow then withdrew from the meeting.

Report on S. 1336 (Item No. 5). There had been distributed a memorandum dated May 10, 1965, from the Legal Division, attaching a draft of reply to a request from Chairman Eastland of the Senate Committee on the Judiciary for a report on S. 1336, a bill to amend the Administrative Procedure Act. The reply, consisting of a letter and attached report, would express agreement with the underlying philosophy reflected in the provisions of S. 1336, but would describe several respects in which specific provisions were found to be objectionable, with an explanation of the basis for such objections. Although the report represented a self-contained analysis of S. 1336, the letter to Chairman Eastland would refer to three previous occasions on which the Board had submitted reports on proposed amendments to the Administrative Procedure Act.

The principal question raised during discussion related to the provisions of the proposed amendments regarding ratemaking actions by Federal agencies, which, for the Board, would involve such matters as the establishment of discount rates, the setting of stock margin requirements, and the establishment of maximum rates of interest payable on time and savings deposits by member banks. The proposed amendments would delete specific mention of ratemaking activities from the definition of "rule." Although it appeared that the definition could still be read reasonably as including ratemaking actions, there was indication of Congressional intent that such actions would be decided under adjudicative procedures; if so, it was suggested that this be made clear in the law.

Under the proposed amendments, only those cases of adjudication that were "required by the Constitution or by statute to be determined on the record after opportunity for an agency hearing" were subject to the notice, pleading, and related requirements of section 5(a). As the Board interpreted section 5, all other cases of adjudication, including the Board's ratemaking actions, were permitted by section 5(b) to be conducted by the agency itself pursuant to procedures provided for by agency rule. Thus, the Board's ratemaking functions could be conducted under such procedures as were determined by the Board to meet best its statutory responsibilities and to serve the public interest.

The draft report would state that if, contrary to the Board's interpretation of section 5, particularly subsection (b) thereof, the Board's rate actions would be subjected either to the procedural requirements of section 5(a) or to a hearing officer-evidential type procedure under section 5(b), the Board would strongly urge either: (a) retention of the Administrative Procedure Act's classification of agency rate actions as rulemaking functions, or (b) that the Board's actions in respect to the establishment of discount rates, rates of interest payable by member banks on time and savings deposits, and margin requirements be exempted from the requirements of section 5.

Governor Daane raised the question whether it might be preferable to omit this material, on the ground that bringing up the question might result in rejection of the Board's interpretation without adoption of the alternative provisions recommended in the report.

Mr. O'Connell responded that otherwise the Board would not be on record as opposing application of the requirements of section 5(a) to the Board's ratemaking functions. In previous reports on similar proposed legislation the Board had strongly opposed such requirements, and the Legal Division felt that the Board would be in the strongest position if it continued to express opposition.

Further discussion resulted in agreement to retain the language of the draft report in regard to ratemaking functions and adjudications, and also in agreement on an editorial change suggested elsewhere in the report.

Unanimous approval was then given to a letter to Chairman Eastland in the form attached as Item No. 5. It was understood that copies of the letter and report would be sent to all Federal Reserve Banks and that the staff would comply with the request of the American Bankers Association for a copy of the report.

Payment of interest on demand deposits (Item No. 6). There had been distributed a memorandum dated May 10, 1965, from the Legal Division regarding a request from the Federal Reserve Bank of Boston for a ruling on the question whether the rebate of a portion of the interest on a loan by a national bank in consideration of the borrower's maintaining a minimum checking account balance with the bank would constitute a payment of interest on a demand deposit in violation of section 19 of the Federal Reserve Act and Regulation Q, Payment of Interest on Deposits.

Under the plan, interest was computed at the time the loan was made and the amount of the interest was added to the face of the note. At the same time, 1/2 of 1 per cent a year of the initial loan, excluding interest, was used to draw a cashier's check on the bank payable to the order of the borrower and/or the bank. The check was retained by the bank and, when the loan was paid in full, was turned over to the borrower if he had maintained a demand deposit account with the bank for an average monthly balance of $100 and if he had paid the loan instalments as they became due.

The memorandum stated the opinion of the Legal Division that the plan involved payment of interest on a demand deposit. Material cited in support of that opinion included a 1954 Board ruling to the effect that a repayment of interest in return for the borrower's maintaining a demand deposit with the bank constituted a payment of interest on the demand deposit. A draft of letter to the Federal Reserve Bank of Boston reflecting the Legal Division's opinion was attached to the memorandum.

After comments by Mr. Forrestal, Governor Robertson remarked that while he agreed with the soundness of the position proposed to be taken, he found some difficulty in reconciling it with accepted banking practice in regard to compensating balances. There ensued a discussion in which Mr. Forrestal acknowledged that the question was close. However, the dividing line seemed to be an actual payment or rebate by a bank conditioned upon maintenance of a deposit, which was deemed a prohibited payment of interest. On the other hand, if a bank, in view of the maintenance of a certain deposit balance, refrained from making a charge it otherwise would have made, this had not been considered to constitute a payment of interest. Similarly, a loan granted at a favorable rate of interest in consideration of the size of the borrower's account had not been regarded as constituting a payment of interest; moreover, in such a case the rate of interest was

specified in the note and could not be changed as to that note even if the borrower withdrew his account.

Chairman Martin commented that it would be difficult to rule in this case that a payment of interest was not involved, particularly in view of earlier Board interpretations, and there was general agreement with this comment.

Further discussion resulted in revision of the draft letter to request that the Federal Reserve Bank of Boston convey the Board's view to a Boston national bank that was already using the plan in question as well as to another that had raised the question because it was contemplating using the plan. It was understood that the substance of the letter would be sent to the other Federal Reserve Banks for their guidance and, since the ruling was applicable to national banks, it was also understood that a copy of the letter would be sent to the Comptroller of the Currency.

The letter was then approved unanimously in the form attached as Item No. 6.

Messrs. Hooff, Forrestal, and McClintock then withdrew from the meeting.

Regulation T question (Item No. 7). Pursuant to action by the Board on July 24, 1963, there had been published in the Federal Register on August 20, 1963, for comment, a proposed amendment to section 220.4(c)(3) of Regulation T, Credit by Brokers, Dealers, and Members of National

Securities Exchanges, that would adapt payment provisions of the Regulation to the mechanics of a refunding by permitting payment (in a special cash account) of the purchase price of the new security to be deferred until the proceeds of redemption of the old security were available to the purchaser. The announcement of proposed rule making in the Federal Register stated that the amendment would supersede a ruling of the Board contained in the last four paragraphs of an interpretation published in the November 1940 Federal Reserve Bulletin, which ruling would be withdrawn upon the effective date of the amendment. The Legal Division recommended withdrawal of that portion of the ruling on the ground that it was unnecessarily broad; it allowed a customer to deposit a called security as payment for any other security without any limitation on the time that might elapse between purchase of the new security and redemption of the old.

The Legal Division's memorandum of April 6, 1965, which was distributed preceding the adoption by the Board on April 19, 1965, of the amendment to Regulation T, effective May 15, 1965, was accompanied by a summary and analysis of comments received in response to the invitation in the Federal Register. After discussing the merits of comments by the New York Stock Exchange and others regarding the prospective withdrawal of the last four paragraphs of the 1940 interpretation, the Division reiterated its recommendation for withdrawal, and the Board's action contemplated that this would be done.

There had now been distributed a memorandum dated May 7, 1965, from the Legal Division regarding a request by the New York Stock Exchange that the Board consider reinstating the withdrawn portion of the 1940 ruling. The memorandum noted that the April 29, 1965, letter in which Mr. Funston, President of the Exchange, made the request repeated objections that were reported in the Legal Division's memorandum of April 6 and considered by the Board at the time the amendment to the Regulation was adopted. The Division recommended that the Board reaffirm its position, and a draft of letter to Mr. Funston to that effect was attached to the memorandum.

Mr. Shuter commented in explanation of the Legal Division's recommendation and, after a discussion of the basis for the New York Stock Exchange's request and agreement on deletion of the last sentence of the draft, the letter was approved unanimously in the form attached as Item No. 7.

Mr. Shuter then withdrew from the meeting.

Interlocking directorates (Item No. 8). There had been distributed a memorandum dated May 7, 1965, from the Legal Division regarding a question raised by the Federal Reserve Bank of Kansas City as to the permissibility under the Clayton Act of interlocking directorates between an industrial bank in Colorado and a member bank. Two particular situations were involved: one concerned the service of Mr. H. L. Sturgeon as President of Rocky Ford National Bank, Rocky Ford, Colorado, and as a

director and Cashier of First Industrial Bank of Rocky Ford; the other concerned the service of Mr. W. E. Shelton as a director of the same two institutions. Section 8 of the Clayton Act forbade private bankers and directors, officers, or employees of member banks to serve at the same time as directors, officers, or employees of any other banking organization under the National Bank Act or under the laws of any State. The Board had authority (exercised through Regulation L, Interlocking Bank Directorates under the Clayton Act) to permit persons to serve in one nonconforming interlocking relationship, although it had done so only where clearly in accordance with the spirit of the statute, and the Clayton Act exempted from its prohibition mutual savings banks and six other specific types of situations.

The question would be a routine one, the memorandum continued, clearly covered by outstanding Board interpretations of section 8 according to which the prohibition in the statute would apply to the situations of Messrs. Sturgeon and Shelton, were it not for two special circumstances. The first was that the background correspondence included a letter to Mr. Sturgeon from the Regional Comptroller of the Currency holding that the interlocking service was permitted under the sixth paragraph of section 8 of the Clayton Act on the ground that the two institutions were not engaged in the same class or classes of business. The Legal Division's view was that not only was the sixth paragraph of section 8 inapplicable in the present case but that there were in fact

at least two classes of business common to the two institutions. The second special circumstance was that Vice President Royer of the Federal Reserve Bank of Kansas City, who had submitted the question, apparently assumed that a 1963 ruling by the Board that as a general rule industrial banks are not "banks" for purposes of section 2(c) of the Bank Holding Company Act also applied under section 8 of the Clayton Act. Although he was mistaken in that assumption, his conclusion, based on a part of the interpretation that held that an industrial bank was nonetheless a bank if it accepted certain types of deposits, was that the interlocking directorships in question were prohibited by the statute. The Legal Division likewise found the relationships prohibited (though on different grounds), and this view was in accord with previous Board decisions in regard to interlocking directorships under section 8 of the Clayton Act.

A draft of letter to Vice President Royer was attached to the memorandum. The Legal Division recommended that, if the Board adopted the proposed position, the substance of the letter be sent to the other Reserve Banks for their information regarding the somewhat different treatment of industrial banks under the Clayton Act and under the Bank Holding Company Act.

Miss Hart made summary comments, after which Governor Maisel referred to a statement in the draft letter that section 8 did not forbid interlocking service between a bank and a Federal savings and loan association for the reason that the statute applies only to banks,

banking associations, savings banks, or trust companies "organized under the National Bank Act or organized under the laws of any State or of the District of Columbia." He asked if this was intended to indicate that any institution that did not include the word "bank" in its title was not covered, such as "thrift associations" or "savings associations" in California.

Staff comments brought out that some banking statutes specified that they did or did not apply to certain types of institutions, such as Federally-chartered savings and loan associations. Because of differences among statutes, the Board had not found it feasible to adopt a definition of "bank" for uniform application. Instead, in the absence of specific statutory guidance, it had judged particular institutions on a case-by-case basis according to their functions. The determination whether or not a given institution was a "bank" did not depend upon its name; a primary consideration was whether or not its operations showed the essential characteristics of accepting deposits, even though some other term for them might be used.

After further discussion during which there was agreement upon a change in language designed to avoid an impression such as Governor Maisel had mentioned, the letter to Vice President Royer was approved unanimously in the form attached as Item No. 8, it being understood that the substance of the letter would be furnished to the other Federal Reserve Banks.

Section 32 question (Item No. 9). There had been distributed a memorandum dated May 3, 1965, from the Legal Division regarding an inquiry from the Federal Reserve Bank of San Francisco as to whether the securities firm of Wheeler, Munger & Co., Los Angeles, California, was primarily engaged in activities described in section 32 of the Banking Act of 1933. If the firm was so engaged, the prohibitions of the Act forbade a limited partner in the firm from serving as an employee of United California Bank, Los Angeles, a State member bank. The firm described the bulk of its business as "investing for its own account." However, it had a seat on the Los Angeles branch of the San Francisco Stock Exchange and acted as specialist and odd-lot dealer on the floor of the exchange. It also did enough business as an ordinary dealer so that if this activity alone were considered the case would be a borderline one under section 32. Hence the question resolved itself into whether in the circumstances of this case, investing for the firm's own account should also be taken into consideration, in which event the firm would clearly be "primarily engaged."

There was set out in the memorandum an analysis of the securities firm's business and the relevance of positions taken previously by the Board as to situations that were similar to some degree. On the basis of that analysis the Legal Division concluded that, since section 32 of the Banking Act of 1933 was designed to prevent situations from arising in which a bank director, officer, or employee could influence the bank

or its customers to invest in securities in which his firm had an interest, regardless of whether he, as an individual, was likely to do so, it was believed that if a firm was doing any significant amount of ordinary dealing or underwriting, a determination whether the firm was "primarily engaged" in section 32 activities should take into consideration investments for the firm's own account. The line between dealing for one's own account and dealing with customers was highly subjective, and although a particular firm or individual might be scrupulous in separating the two, the opportunity necessarily existed for the kind of abuse at which the statute was directed. Therefore, the Division recommended that the Board answer the inquiry affirmatively, along the lines of a draft letter to the Federal Reserve Bank of San Francisco that was attached to the memorandum. The Division recommended also that the substance of the letter be sent to the other Reserve Banks for their guidance, since there had been some confusion from time to time about the application of section 32 to activities of a dealer.

After discussion, the letter was approved unanimously, with the understanding that the substance of the letter would be sent to the other Federal Reserve Banks. A copy of the letter is attached as Item No. 9.

Miss Hart then withdrew from the meeting.

Court decisions regarding bank mergers (Item No. 10). With a memorandum dated April 30, 1965, from the Legal Division there had been

distributed a draft of reply to a letter in which Chairman Fascell of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations expressed concern about "the grave problems which can arise in bank merger cases, where the stamp of approval has been affixed by a banking agency, only to have it destroyed at some future time through the efforts of another agency of the Government, the Anti-trust Division." Chairman Fascell asked whether such situations could be avoided under existing law, and for views and suggestions for dealing administratively with the problem.

Mr. Shay observed that the essence of the proposed reply was that such problems could not be avoided through administrative measures under present law. Although the agency having jurisdiction had to ask the other Federal banking authorities and the Department of Justice for reports on competitive factors, the Bank Merger Act made it clear that such factors represented only one aspect of an application and that in some situations other considerations should be given greater weight. Responsibility for evaluation of all aspects of a proposal rested with the agency having jurisdiction, and the Legal Division considered that any procedure under which the several agencies would confer prior to a decision in order to resolve their differences as to the over-all effect of a merger proposal would involve an abuse of administrative discretion.

There ensued a general discussion of the considerations taken into account by the courts in antitrust cases. In recent banking cases

there had been indications that the competitive factors involved in a merger had been almost the sole consideration, with little or no weight being given to banking factors. However, in other merger cases the courts had recognized the failing company doctrine, and a view was expressed that even though a court found that a bank merger violated the antitrust law under which suit was brought, it would be within the discretion of the court to make a further finding that the financial condition of one or both institutions warranted consideration. There was agreement that it would appear safest to resort to a factual comment that in recent bank merger decisions the courts had given little if any weight to the banking factors.

Suggestions then were made for various other revisions in the approach and emphasis of the draft letter, especially in the interest of compatibility with the Board's letter of April 27, 1965, to Chairman Robertson of the Senate Committee on Banking and Currency reporting on S. 1698, a bill that would exempt bank mergers from the Federal antitrust laws.

At the conclusion of the discussion, unanimous approval was given to a reply that would take these suggestions into account. A copy of the reply in the form in which it was subsequently transmitted to Chairman Fascell is attached as Item No. 10.

Monograph on banking markets. In a distributed memorandum of May 3, 1965, Mr. Brill, Director, Division of Research and Statistics,

recommended that the Board publish the monograph, "Banking Market Structure and Performance in Metropolitan Areas," by Theodore G. Flechsig. The monograph would be published with a foreword indicating that the analysis and conclusions were the sole responsibility of Mr. Flechsig and not of the Board or of the Federal Deposit Insurance Corporation (Mr. Flechsig, formerly of the Board's staff, was now a member of the Corporation's staff). The recommendation contemplated the printing of 3,000 copies of the monograph in the Board's shop at an estimated out-of-pocket expense of $680, for which provision had been made in the 1965 budget. The intended initial distribution was described in the memorandum, followed by a recommendation that copies be made available to the public without charge and that the monograph be announced in the Federal Reserve Bulletin and included in the list of Board publications.

Mr. Brill also recommended that the monograph, "Bank Mergers & The Regulatory Agencies -- Application of the Bank Merger Act of 1960," by George R. Hall and Charles F. Phillips, Jr., be added to the list of publications in the Bulletin. When this monograph was published in August 1964, certain considerations suggested avoiding undue publicity, but those reasons no longer seemed compelling.

After comments by Mr. Holland, Governor Maisel remarked that in his experience it was generally preferable to list a charge for publications even though they might be made available rather freely

to parties having a well-defined interest in them. He inquired about Board policy in this regard.

During the discussion that followed it was brought out that the Board had set the prices and terms for distribution of its publications individually, but had not adopted an over-all price policy. In general, if a publication contained subject matter of wide general interest to the public it was normally distributed free of charge. If it was of a technical nature and of more limited interest, a charge was usually made for it, at least to the general public. The suggestion was made that the staff be requested to develop recommendations for a general pricing policy for the Board's publications.

At the conclusion of the discussion the recommendations in Mr. Brill's memorandum were approved unanimously, except that the matter of price of the Flechsig monograph was held in abeyance pending consideration by the Board of recommendations to be developed by the staff for a general pricing policy on publications.

The meeting then adjourned.

Secretary's Notes: On May 11, 1965, Governor Shepardson approved on behalf of the Board a memorandum from Mr. Sherman dated May 10, 1965, recommending that a small luncheon be arranged at the Cosmos Club on May 12 for two officials of the Bank for International Settlements who would be visiting the Board's offices, with payment by the Board of the cost.

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

Memorandum from Mr. Young, Adviser to the Board and Director, Division of International Finance, dated May 11, 1965, recommending that a small dinner be arranged at the International Club for representatives of the Bank of England and the U.K. Treasury who were to be in Washington beginning Monday, May 17, for discussion of the international payments system, with payment by the Board of the cost of the dinner.

Memorandum from the Division of Research and Statistics dated May 3, 1965, requesting that an economist position vacancy in the Business Conditions Section of that Division be filled temporarily by an appointment from about June 15 to September 15, 1965.

Letter to the Federal Reserve Bank of New York (attached Item No. 11) approving the appointment of Franklin T. Love as assistant examiner.

Letter to the Federal Reserve Bank of Kansas City (attached Item No. 12) approving the appointment of Philip Edgar Schmidt as assistant examiner.

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

Appointment

Edward S. Green as Cafeteria Laborer, Division of Administrative Services, with basic annual salary at the rate of $3,385, effective the date of entrance upon duty.

Transfers

Katherine M. Bulow, from the position of Clerk-Stenographer in the Division of International Finance to the position of Secretary in the Division of Research and Statistics, with an increase in basic annual salary from $4,780 to $5,165, effective upon assuming her new duties.

Adeline R. Tweed, from the position of Budget and Planning Assistant in the Office of the Controller to the position of General Assistant in the Division of Data Processing, with an increase in basic annual salary from $6,450 to $7,220, effective May 23, 1965.

Secretary

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

Item No. 1
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 12, 1965.

Marine Midland International
Corporation,
120 Broadway,
New York, New York. 10005

Gentlemen:

In accordance with the request in your letter of April 21, 1965, transmitted through the Federal Reserve Bank of New York, and on the basis of information furnished, the Board of Governors grants consent to your Corporation's purchase and holding of approximately 21,500 shares, par value pesetas 1,000 each, of Financiera Espanola de Inversiones ("FEI"), Madrid, Spain (in formation), at a cost of approximately US$500,000, provided such stock is acquired within one year from the date of this letter.

The Board also approves the purchase and holding of shares of FEI within the terms of the above consent in excess of 10 per cent of your Corporation's capital and surplus.

The foregoing consent is given with the understanding that the foreign loans and investments of your Corporation, including the investment now being approved, will not exceed the guidelines established under the voluntary foreign credit restraint effort now in effect and that due consideration is being given to the priorities contained therein.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

Item No. 2
5/12/65

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Application of

UNITED CALIFORNIA BANK

for approval of merger with Bank of Ceres

ORDER APPROVING MERGER OF BANKS

There has come before the Board of Governors, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), an application by United California Bank, Los Angeles, California, a State member bank of the Federal Reserve System, for the Board's prior approval of the merger of that bank and Bank of Ceres, Ceres, California, under the charter and title of United California Bank. As an incident to the merger, the sole office of Bank of Ceres would become a branch of the resulting bank. Notice of the proposed merger, in form approved by the Board, has been published pursuant to said Act.

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

IT IS HEREBY ORDERED, for the reasons set forth in the Board's Statement of this date, that said application be and hereby is approved, provided that said merger shall not be consummated (a) within seven calendar days after the date of this Order or (b) later than three months after said date.

Dated at Washington, D. C., this 12th day of May, 1965.

By order of the Board of Governors.

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

Voting against this action: Governor Robertson.

Absent and not voting: Governor Daane.

Governor Maisel did not participate in this action.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

(SEAL)

Item No. 3
5/12/65

BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

APPLICATION OF UNITED CALIFORNIA BANK
FOR APPROVAL OF MERGER WITH
BANK OF CERES

STATEMENT

United California Bank, Los Angeles, California ("United"), with total deposits of $2.7 billion, has applied, pursuant to the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), for the Board's prior approval of the merger of that bank and the Bank of Ceres, Ceres, California ("Ceres Bank"), which has total deposits of $3.6 million.[1/] The banks would merge under the charter and name of United, which is a State member bank of the Federal Reserve System and the only banking subsidiary in California of Western Bancorporation, a registered bank holding company. As an incident to the merger, the sole office of Ceres Bank would become a branch of United, increasing the number of its offices from 178 to 179.

Under the law, the Board is required to consider, as to each of the banks involved, (1) its financial history and condition, (2) the adequacy of its capital structure, (3) its future earnings prospects, (4) the general character of its management, (5) whether its corporate powers are consistent with the purposes of 12 U.S.C., Ch. 16 (the Federal Deposit Insurance Act), (6) the convenience and needs of the community to be served, and (7) the effect of the transaction on competition

1/ The deposit figures cited throughout are as of June 30, 1964.

(including any tendency toward monopoly). The Board may not approve the transaction unless, after considering all of these factors, it finds the transaction to be in the public interest.

Banking factors. - The financial histories of United and Ceres Bank are satisfactory, and each bank has a satisfactory asset condition and a reasonably adequate capital structure. The earnings record and future earnings prospects of United are satisfactory. While the earnings of Ceres Bank have been adequate, they are well short of the reasonable earnings potential of the bank. The relatively low earnings of Ceres Bank appear to be the result of the investment and loan policies of its ultraconservative management. For example, the bank invests exclusively in short-term U. S. Government obligations. The management of United is competent and progressive, as would be the management of the resulting bank, which would also have a satisfactory financial condition, a reasonably adequate capital structure, and favorable future earnings prospects.

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

Convenience and needs of the communities. - Ceres has a population of approximately 4,500 and is located in Stanislaus County, California, about 120 miles east of San Francisco. The economy of Ceres is based chiefly on agricultural activities, but it is growing as a residential community.

Ceres Bank makes available only very limited services relative to the banking needs of the Ceres area. The loan volume of Ceres Bank as a percentage of its total deposits is very low as compared to other banks in the area, and about one-third of these loans are participations purchased from banks outside the community. The bank does not make FHA or VA loans, interim real estate loans, or a number of other types of loans - including the installment variety - ordinarily available through commercial banks. These and other services not provided by Ceres Bank are available at other relatively nearby banking offices, including the Ceres branch of the seventh largest bank in California located one block from Ceres Bank. However, the proposed merger would have the advantage of providing for the Ceres community an alternative source of relatively full banking services.

The proposed merger would have no appreciable effect on the banking needs and convenience of the communities in which United presently has banking offices.

Competition. - The service area[2/] of Ceres Bank may be approximately defined as the area contained within a radius of about three to nine miles of Ceres, and includes the town of Hughson where the only banking office is a branch of a large Oakland headquartered bank. Although they are not within the service area of Ceres Bank, banking offices located in the towns of Modesto (population about 43,000) and Turlock (population about 9,000) which are situated, respectively, about five miles north and eight miles south of Ceres, derive some business from the Ceres community. Although seven banks operate 12 banking offices

2/ The area from which a bank obtains 75 per cent or more of its deposits of individuals, partnerships, and corporations.

in Modesto, only five downtown offices - one each of United and the State's first, third, fourth, and seventh largest commercial banks in terms of total deposits - are situated where they can reasonably be expected to attract business from the Ceres area. The five banking offices in Turlock are branches of four of these same banks, one of them being United.

With the acquisition of Ceres Bank, United would own three of 13 banking offices operated by six banks in the relevant area as described in the preceding paragraph, and its holdings of total deposits in this area would increase from about 8.8 per cent to 11.5 per cent. However, its ranking of fifth in this respect would remain unchanged. United is the fifth largest bank in California with about 8.2 per cent of the total deposits of all the State's commercial banks, and its share would be increased by about .01 per cent with the acquisition of Ceres Bank. There is no indication that any other bank in the relevant area would be adversely affected by the proposed merger. The merger would eliminate the limited amount of competition that exists between the proponent banks, and foreclose also such potential for competition as there may be. However, United would be a much more effective competitor for the two offices of the large banks that now operate in the service area of Ceres Bank.

Summary and conclusion. - Although the merger would foreclose the limited existing and potential competition between the proponent banks and increase slightly the resources of the State's fifth largest bank, it does not appear that the transaction would have a significantly

adverse effect on banking competition. Indeed, the replacement of the nonaggressive Ceres Bank by an office of United would enhance banking competition in the local market area; at the same time, United would serve as an alternative source of full banking services, all of which would redound to the net benefit of the community concerned.

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

May 12, 1965.

Item No. 4
5/12/65

DISSENTING STATEMENT OF GOVERNOR ROBERTSON

The Board, by its approval of this application, gives sanction to a transaction with consequences that, in my judgment, fall precisely within the realm of that which the Bank Merger Act of 1960 was designed to prevent.

As a basis for approval, the majority accords great weight to its finding that the merger would result in an alternative source of full banking services for the Ceres community. The record shows, however, as the majority acknowledges, that the seventh largest bank in California (a billion dollar institution) operates an office one block from Ceres Bank, and that there are eleven more competing banking offices - ten of them owned by five of the State's seven largest banks - situated in nearby towns, some five to eight miles distant. The facts here obviously would not support a finding that the banking needs and convenience of the community are not being adequately served, and the majority makes no such finding. To attach any significance whatsoever to the convenience and needs factor on a record such as the one in this case is, I submit, merely to offer a placebo for the violence that, through this and like cases, is being done to banking competition and to the public interest.

United, the fifth largest bank in California, and the first, third, fourth, and seventh largest banks together account for nearly 70 per cent of the total deposits of all the State's commercial banks.

These same five banks, with 11 of the 13 banking offices in the area treated by the majority as the relevant geographical market, hold nearly 94 per cent of the total deposits held by the seven commercial banks operating offices there. Under these circumstances even a slight increase in the concentration of banking resources through the acquisition of sound banks is clearly prohibitive.[1/] Yet the majority, while conceding that the merger would foreclose competition between the proponent banks, concludes that the elimination of the last remaining independent bank in the relevant geographical market - with the five large banks then owning all but one of the banking offices and holding nearly 97 per cent of the total deposits - would actually enhance banking competition. In this connection, the majority points to the Ceres Bank's lack of aggressiveness. It cannot be gainsaid, however, that the bank has been aggressive enough to survive comfortably, and it apparently has been a reasonably effective competitor since United is willing to pay a pretty premium for its purchase. More fundamentally, the majority fails to comprehend that by its willingness to approve mergers under the circumstances of this case, it effectively removes the need for banks such as Ceres Bank to adopt progressive policies or, when a sale is contemplated, to seek out a buyer - other than a dominant firm in the industry - who may be willing to adopt such policies.

1/ See the discussion on this point in my Dissenting Statement at 51 Federal Reserve Bulletin 98 (1965).

The Board's reasoning in this case would permit the eight largest banks in California, which now hold about 88 per cent of the total commercial bank deposits in the State, to acquire the banks holding the remaining 12 per cent, thus resulting in a complete oligopoly. The general application of the Board's reasoning in this case would seal the doom of the Bank Merger Act.

I would deny the application.

May 12, 1965.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 5
5/12/65

OFFICE OF THE CHAIRMAN

May 12, 1965

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

Dear Mr. Chairman:

This is in response to your letter received by the Board on March 25, 1965, requesting a report on S. 1336, a bill "To amend the Administrative Procedure Act, and for other purposes."

It is the Board's opinion that S. 1336, viewed in its entirety, contains guidelines for administrative agency procedures reasonably calculated to further the public interest or policy underlying the many and varied laws administered by agencies of the Government, while according the individuals dealing with these agencies maximum recognition of the rights secured to them under law. At the same time, the Board finds several of the specific provisions of S. 1336 objectionable, either as they affect the Board in particular or in their probable effect on all agencies generally.

The substance of certain of the comments that follow has been transmitted previously to the Committee on the Judiciary or to that Committee's Subcommittee on Administrative Practice and Procedure in response to requests for views on proposed legislation relating to agency practices and procedures. By letter to you of July 11, 1963, the Board reported on S. 1666, a bill that would have amended the public information provisions of the Administrative Procedure Act. On November 6, 1963, the Board responded to your request for views on S. 1663, the provisions of which in several respects paralleled those of S. 1336. The Board's detailed comments on S. 1663 were set forth on analysis forms provided by the Committee and were forwarded as enclosures to the Board's November 6 letter of comment. Subsequently, by letter of July 1, 1964, the Board submitted to Senator Edward V. Long, Chairman of the Subcommittee on Administrative Practice and Procedure of the Committee on the Judiciary, views and comments on a new comparative print of S. 1663. In many respects the revised form of S. 1663 more closely paralleled the language of certain of the provisions of S. 1336 than did the original version of S. 1663. Accordingly, some of the Board's comments regarding S. 1663, as revised, are herein restated.

In view of the similarity that certain of the provisions of S. 1336 bear to some of the provisions of one or more of the three earlier bills mentioned, the Board believes that the Committee may find helpful, in respect to its deliberations on S. 1336, the views and comments contained in the Board's letters of July 11, 1963, * November 1, 1963, and July 1, 1964. At the same time, it is the Board's belief that the enclosed comments on S. 1336 represent a self-contained analysis of the bill's provisions, in respect to their effect on the Board's functions and related procedures, and on certain aspects of Government agency procedures in general.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure

* Should have read November 6, 1963.

BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

Report on S. 1336

Sec. 2 - Definitions

The most significant change made by Sec. 2 of S. 1336 is the removal from the definition of "rule", as that term is defined in the Administrative Procedure Act (hereinafter "the APA"), of "the approval or prescription for the future of rates, ..." Despite the deletion of the language relating to ratemaking actions, the definition of "rule" as "the whole or any part of any agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy . . ." can still be read reasonably as including agency ratemaking actions. The reasonableness of this conclusion is further strengthened by the fact that the deleted language is not carried over to Sec. 2(d) where "Order" and "Adjudication" are defined.

However, remarks of Senator Dirksen, a co-sponsor of S. 1336, made at the time the bill was introduced, indicate Congressional intent that under S. 1336 agency rate actions "would be decided under the adjudicative procedures [Sec. 5] of the agency". (Cong. Rec., March 4, 1965, p. 3982) If agency rate actions are to be considered "adjudications" under S. 1336, this should be made clear by transfer to Sec. 2(d) of the specific language relating to that function.

As applied generally to all agencies, the proposal to place ratemaking functions under the agencies' adjudication procedures appears to have merit. In most agencies there exists a pressing need to assure agency members of maximum time to consider and act upon matters of policy. Logically, this can be done best by relieving agency members of as many decisional functions as possible. As applied to the Board's ratemaking actions, however, it would be undesirable to have responsibility for the initial decision elsewhere than in the agency itself. The Board's actions in the field of ratemaking are intrinsically policy-making functions. They involve the establishment of discount rates (the rates to be charged on loans and discounts by the Federal Reserve Banks to member banks of the Federal Reserve System), the setting of stock margin requirements (the amount of credit which may be extended to a customer by brokers, dealers, or members of a national securities exchange, or by banks for the purchase and carrying of registered securities), and the establishment of maximum rates of interest payable on time and savings deposits by member banks.

The decisional processes underlying the Board's actions in establishing discount rates, rates of interest on time and savings deposits, and margin requirements preclude the treatment of these functions as mere fact-finding actions to be subjected to the same procedural and decisional processes as are applicable to the fixing of freight, passenger, or utility rates. In this respect, the Board notes that only those cases of

adjudication which are "required by the Constitution or by statute to be determined on the record after opportunity for an agency hearing" are subject to the notice, pleadings, pre-hearing conferences, hearing procedures, separation of functions, and emergency action provisions of Sec. 5(a). As the Board interprets Sec. 5, all other cases of adjudication, including the Board's ratemaking actions, are permitted by Sec. 5(b) to be conducted by the agency itself pursuant to procedures provided for by agency rule. Thus, the Board's ratemaking functions could be conducted under such procedures as are determined by the Board to best meet its statutory responsibilities and to serve the public interest.

If, contrary to the Board's expressed interpretation of Sec. 5, particularly of subsection (b) thereof, the Board's rate actions would be subjected either to the procedural requirements of Sec. 5(a) or to a hearing officer - evidential type procedure under Sec. 5(b), the Board would strongly urge either:

(a) retention of the APA's classification of agency rate actions as rulemaking functions and, as now provided, an exception for such actions from the notice and public procedure requirements "in any situation in which the agency for good cause finds that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest"; or

(b) that the Board's actions in respect to the establishment of (1) rates of interest on discounts and advances by Federal Reserve Banks; (2) rates of interest to be paid by member banks of the

Federal Reserve System on time and savings deposits; and

(3) margin requirements be exempted from the requirements of Sec. 5. Either alternative would permit the Board to apply its expert knowledge and experience in these highly complicated areas of national economic policy, unimpeded by procedural requirements which, if applied, could imperil the Board's ability to formulate and implement policy in credit and monetary matters and impede its ability to respond promptly and with the required flexibility to the day-to-day dictates of national economic policy.

Sec. 3 - Public Information

Sec. 3 of S. 1336 would make substantial and far-reaching changes in the "public information" provisions of Sec. 3 of the APA. In introducing the bill, Senator Dirksen stated that Sec. 3 of S. 1336 "changes the availability of Government information from a question of agency discretion to a requirement that the information be made available unless it fall within certain exempted categories." (Cong. Rec., March 4, 1965, p. 3983)

The Board views favorably the purpose underlying the provisions of Sec. 3 of S. 1336. When access to information to which the public is entitled is foreclosed by agency action based upon existing provisions of law, remedial legislation appears warranted. Despite this general accord with the purpose of Sec. 3, the Board finds several of its provisions to be unduly severe in the requirements imposed on the agencies, and to require disclosure of agency records to an extent and in a manner inconsistent with the public interest.

Sec. 3(e) of the bill contains eight specific exemptions from the provisions of Sec. 3. These would take the place of (1) the two general exceptions to the APA's public information requirements relating to "any functions of the United States requiring secrecy in the public interest" and "any matter relating solely to the internal management of an agency"; and (2) the specific exception to the "opinions and orders" and "public records" requirements of matters held confidential for good cause found. Viewed in the light of the Board's continuing functions in the areas of credit and monetary policy, and bank supervision and regulation, the eight exemptions from the requirements of Sec. 3 are considered by the Board to offer reasonable assurance against unwarranted disclosures. However, a literal construction of these exemptions leads to the belief that there would remain exposed to indiscriminate public demand certain critial records of the Board, disclosure of which could impair the Board's effectiveness both as an instrument of national economic policy and as a regulatory body. Accordingly, while being favorably disposed to the form and content of the eight exemptions in Sec. 3(e) of the bill, the Board urges retention of the exceptions from publication now found in the preamble and in subsections (b) and (e) of Sec. 3 of the APA.

Sec. 3(b) of the bill, dealing with the requirements for availability for public inspection and copying of agency final opinions, orders in the adjudication of cases, statements of policy and interpretations adopted by the agency, etc., deletes an existing provision of

the APA whereby an agency may withhold from public access all final opinions or orders in the adjudication of cases for good cause found, when not cited as precedents. S. 1336 does provide that an agency may delete identifying details to the extent required to prevent a clearly unwarranted invasion of personal privacy.

The Board is opposed to the removal from the law of the provision authorizing an agency to withhold from public availability opinions, orders, or statements of policy "required for good cause to be held confidential and not cited as precedents". Further, the exception provided in S. 1336 regarding deletion of identifying details is not, in the Board's opinion, an adequate alternative to the present nondisclosure authority. Inasmuch as the bill recognizes that there can be cases in which there would occur a "clearly unwarranted invasion of personal privacy", the Board believes that a far more workable and equitable basis for nondisclosure is that provided in the present Sec. 3(b) of the APA.

Sec. 3(b) of the bill would also require that every agency maintain and make available for public inspection and copying a current index providing identifying information for the public as to any matter which is issued, adopted, or promulgated and which is required by subsection (b) to be made available or published. The Board urges that the requirement for a current index be made subject to the same exception as has been urged in respect to the publication of opinions and orders, namely, that there be excluded from the current index requirements

"identifying information" that the agency for good cause shall hold confidential and not cited as precedents.

The Board is opposed to the provisions in Sec. 3(c) of the bill that would require every agency to "make all its records promptly available to any person". [Underscoring supplied.] Presently, the APA requires that matters of official record shall be made available "to persons properly and directly concerned". This provision, if combined with the judicial enforcement provision in Sec. 3(c) of the bill, would, in the Board's judgment, assure an equitable balancing of the need of Federal agencies to determine themselves what records and information a particular person should or need have, with the public's right to such records and information. The words "any person" become the more objectionable because of their presence in the subsequent provisions of the bill permitting court action to obtain a court order requiring production of agency records.

The foregoing comments combining references to the phrase "any person" and the provisions affording court assistance when an agency has wrongfully withheld records and information should not be construed as Board opposition to the court enforcement provisions per se. On the contrary, the Board is in sympathy with the need for a form of judicial enforcement, and is generally in accord with the means to this end proposed in Sec. 3(c) of the bill. However, the Board does oppose giving "any person", whether or not properly and directly concerned, access to all agency records not specifically exempted and, upon mere allegation of improper withholding, permitting "any person" to bring suit to obtain an

order requiring production. Admittedly, the bill would require that issuance of such court order be premised upon a finding that the record demanded but not produced was improperly withheld. The requirement of such finding is viewed as a relatively minimal deterrent both as to unwarranted demands for disclosure and as to the number of baseless complaints that could be filed seeking judicial relief.

In respect to such complaints, the bill places upon the agency the burden of sustaining its action in withholding records or information from "any person". As a result, in any case where the records sought do not fall within one of the eight exemptions contained in Sec. 3(e), in attempting to have sustained its administrative action, the agency would be denied the opportunity of showing that the person demanding production of the records is not properly and directly concerned with the matter reflected in such records. Such opportunity is available presently under the APA.

In sum, the Board finds equitable and reasonable the placement upon the agency of the burden of sustaining its action in withholding matters of record. That burden becomes unreasonable, however, by inclusion in Sec. 3(c) of the provision requiring that every agency make its records available to "any person". The Board submits that the Congressional intent inherent in the proposed language of Sec. 3(c) would be equally realized by language that would combine the provisions of Sec. 3 of the APA with the court enforcement provisions of the bill, the latter appropriately adjusted to the language of Sec. 3 of the APA.

Sec. 4 - Rulemaking

In respect to the changes that Sec. 4 of S. 1336 would make in existing law relating to rulemaking procedures, the Board is opposed to these changes in the following two respects.

Sec. 4(a) of the APA excludes from the "notice of proposed rulemaking" requirements "persons . . . named and either personally served or [who] otherwise have actual notice thereof in accordance with law". S. 1336 would make the notice requirements applicable even as to persons personally served or who have actual notice of proposed rulemaking. The Board opposes the deletion of the exclusion now applicable to persons served or who have actual notice, and believes that elimination of this exception would place upon the agencies an unnecessary and burdensome procedure.

Sec. 4(c)(2) of S. 1336 would make applicable the requirements of Sec. 7 ("Hearings") where rules are required "by the Constitution or by statute to be made on the record after opportunity for an agency hearing". Sec. 4(b) of the APA makes applicable the provisions of Sec. 7 ("Hearings") and Sec. 8 ("Decisions") only to rules required by statute to be made on the record after hearing.

The Board opposes the coverage within Sec. 7 requirements of rules required by the Constitution to be made on the records, etc. By this change, in addition to following express statutory requirements for hearings that presumably are premised upon Constitutional guarantees, agencies would be obliged to reckon with innumerable aspects of due

process of law in determining whether the requirements of Sec. 7 must be followed. Administrative agencies would be faced with the perplexing dilemma of determining whether a rulemaking hearing is "required" or not. In general, agencies of the Government function within the framework of Congressionally delegated authority. In delegating authority, it is assumed that the Congress will determine the circumstances under and the extent to which the public interest require adherence to the standards of Sec. 7 in the decision-making process. This is particularly true in respect to agency rulemaking, essentially a quasi-legislative function. The Board urges deletion of the reference to Constitutionally required rulemaking hearings.

Sec. 5 - Adjudication

The Board incorporates by reference its earlier comments relating to the proposed classification of agency rate actions as Sec. 5 "adjudications".

Sec. 5(a) provides that all of its provisions shall be applicable in those cases of adjudication which are required by the Constitution or by statute to be determined on the record after an opportunity for agency hearing. For the reasons earlier stated in respect to the Board's opposition to similar language of applicability in respect to rulemaking functions, the Board opposes making all the provisions of Sec. 5 applicable to cases of adjudication which are required by the Constitution to be determined on the record after hearing. As indicated, the Board believes that the requirements of due process

of law in respect either to functions involving rulemaking or adjudication can be assured by appropriate Congressional action at the time agencies' statutes are enacted. To place upon administrative agencies the burden of case-by-case determination as to whether a particular adjudication is required "by the Constitution" to be determined on the record after opportunity for an agency hearing could give rise to administrative delays and judicial appeal proceedings that would be clearly contrary to the principles of expeditious administrative resolution at which S. 1336 is apparently aimed.

The Board favors the changes in existing hearing procedures that would be effected by enactment of Sec. 5(a)(3) and (5). Provisions for prehearing conference that could be utilized in the discretion of the agency or the presiding officer should significantly expedite administrative proceedings, enable greater simplification of complex issues, and better advise both the agencies and other participating parties regarding the probable course of the adjudicative proceedings. Similarly, the provision for modified hearing procedures that fall without the requirements of Sec. 7 appears likely to serve the interests of both the agencies utilizing such abridged procedures and the parties as to whom they are made applicable. The Board believes, however, that the beneficial results intended by utilization of abridged hearing procedures could be substantially thwarted by the fact that such procedures would be utilized only "by consent of the parties". Preferable, it is believed, would be use of such abridged hearing procedures "as the agency in its discretion may designate by rule or order".

Finally, the Board notes with approval the inclusion in Sec. 5(a)(7) of a provision not presently contained in the APA whereby emergency action, found by an agency to be necessary for the preservation of the public health or safety, or as otherwise provided by law, may be taken without the notice or other procedures required by Sec. 5(a).

Sec. 6 - Ancillary Matters

Sec. 6 of S. 1336 would expand the provisions of the APA regarding "Ancillary Matters" so as (1) to make more specific the provisions regarding appearances of attorneys and other representatives of parties before agencies; (2) to provide for the issuance of subpenas upon request to any party to an adjudication unless otherwise provided by statute, and for the issuance of subpenas to any party to a rulemaking proceeding upon request, upon a showing of general relevance and reasonable scope of the evidence sought, and as authorized by law; (3) to make available deposition and discovery procedures to the same extent and in the same manner as in civil proceedings in the district courts of the United States except to the extent an agency deems such conformity impracticable and otherwise provides for depositions and discovery by published rule; (4) to permit an agency to consolidate related proceedings or to order joint hearings on common or related issues in different proceedings; and (5) to issue declaratory orders and to dispose of motions for summary decisions, motions to dismiss, or motions for decisions on the pleadings.

While the Board favors many of the additions that S. 1336 would make in the "Ancillary Matters" provisions of the APA, the Board is opposed to certain of the provisions contained in S. 1336. These are the provisions, or portions thereof, dealing with the issuance of subpenas (Sec. 6(e)), depositions and discovery (Sec. 6(h)), and declaratory orders (Sec. 6(k)).

The Board opposes the language of Sec. 6(e) that would require every agency to provide by rule for the issuance of subpenas upon request to any party to an adjudication unless otherwise provided by statute. Proceedings conducted by the Board or a duly designated representative thereof usually relate to the Board's function as a regulatory and supervisory agency. In the course of such proceedings, the Board is required to have access to and make use of facts and financial data of an extremely sensitive and confidential nature in order properly to discharge its statutory function. The Board does not believe that parties to such proceedings should be permitted to demand access to such information and data through subpenas unless expressly authorized by law to do so. To permit such access could have seriously adverse economic and personal consequences on the banking organizations involved, their representatives, and their customers. For example, disclosure of a bank's resources and amounts of income, its loss experience on consumer loans, the amount of and changes in valuation reserve accounts, its investment and loan portfolio structure, and related financial information could do irreparable damage to the

disclosing bank's financial position. Similarly, compulsory disclosure through subpena of bank officers' salaries, the names of borrowers, the amounts and terms of their loans, and the deposit balances of customers could prove highly prejudicial and irreparably damaging to the individuals or institutions involved. The Board does not believe that provision in Sec. 6 for the quashing or modification of any subpena for lack of general relevance or reasonable scope is sufficient guarantee against indiscriminate or unwarranted disclosure to make acceptable the proposed subpena provisions relating to adjudications.

For the foregoing reasons, the Board strongly urges that the provisions for issuance of subpenas relating to adjudications be made identical with the provisions for the issuance of subpenas in rulemaking proceedings, namely, that agency subpenas authorized by law shall be issued to any party to an adjudication upon request upon a showing of general relevance and reasonable scope of the evidence sought.

Sec. 6(h) would add a provision to existing law making available depositions and discovery to the same extent and in the same manner as the same are available in civil proceedings in district courts of the United States except to the extent an agency deems such conformity impracticable and otherwise provides for depositions and discovery by published rule. In essence, the Board opposes this change for the same reasons expressed in its opposition to the proposed provision in Sec. 6(e) regarding subpenas in cases of adjudication. It is not believed that parties to proceedings before the Board should be permitted to probe

through deposition and discovery procedures the highly confidential details of another's business transactions, particularly in view of the unique public interest considerations involved in the field of banking.

Nor are the Board's objections to the depositions and discovery procedures overcome by the presence in Sec. 6(h) of a provision that an agency might depart from such procedures where the same are found to be "impracticable" and the agency otherwise provides for depositions and discovery by published rule. To permit deviation from the prescribed procedures only if adherence thereto can be shown to be "impracticable", that is, burdensome or difficult in implementation, misses completely the substantive objections that the Board has to the proposed provisions relating to depositions and discovery procedures.

Accordingly, it is recommended that if the depositions and discovery provisions are to remain in S. 1336, following the last word in Sec. 6(h) as now proposed there be inserted the following language ", or where the use of such process by a party would, in the judgment of the agency, be contrary to the public interest, in which case the agency shall by published rule set forth the particular circumstances under which resort to such process shall be allowed."

Finally, in respect to the provisions of Sec. 6(k) directing that an agency shall act upon requests for declaratory orders, the Board believes desirable the insertion of specific language clarifying what appears to be the intent of Congress to make the issuance of a declaratory order a discretionary act upon the part of an agency.

This could be effected by insertion at line 6 of the present provision, immediately following the word "authorized", the phrase "in its sole discretion,".

Sec. 7 - Hearings

Viewed in the context of the changes urged herein in respect to certain of the proposed provisions in Secs. 2, 4, 5, and 6 of S. 1336, the Board does not oppose the proposed provisions of Sec. 7.

Sec. 8 - Decisions

The Board views as generally unobjectionable most of the changes in existing law relating to the decision functions of administrative agencies that would be made by Sec. 8 of S. 1336. The Board does oppose certain of the provisions of Sec. 8 of S. 1336, its major objections being as follows.

Sec. 8 of the APA provides that in cases in which an agency itself has not presided at the reception of evidence at a hearing, the presiding officer shall initially decide the case or, in the alternative, the agency shall require (in specific cases or by general rule) the entire record to be certified to it for initial decision. Sec. 8(a) of S. 1336 would do away with the initial decision procedure by providing that in all adjudications subject to Sec. 5(a) the presiding officer shall make the decision and, in the absence of either an appeal

to the agency or review by the agency within time provided by statute or by rule, the presiding officer's decision shall become the decision of the agency.

At the present time the Board follows the practice in an adjudicatory proceeding of requiring the record of such proceeding to be certified to it for initial decision, following issuance by the presiding officer at the hearing of his recommended decision. Such a procedure, provided for by Sec. 8(a) of the APA, allows the Board to review the facts de novo, to appraise the presiding officer's evaluation of those facts, and either to affirm the presiding officer's recommended decision or alter or reverse the same in the light of the applicable statutory standards.

The Board strongly desires the preservation of its present decision-making procedures whereby an initial decision issued by a presiding officer is reviewed by the Board prior to its becoming a final Board decision. Although there are few occasions upon which the Board conducts adjudications requiring application of the provisions of Sec. 7, when such occasions do arise the nature and the subject of such proceedings are sufficiently technical and sensitive as to require, in the Board's judgment, a final decision to be made in the first instance by the Board itself. Adjudicatory proceedings that would be conducted by the Board might involve termination of a bank's membership in the Federal Reserve System, removal of officers or directors of a bank for unsafe or unsound banking practices or violations of law,

suspension of a bank's access to the credit facilities of the Federal Reserve System, termination of a bank's authority to extend credit to finance securities transactions, revocation of a holding company affiliate's voting permit, or issuance of a cease and desist order under the Clayton Act. As to many of the aforementioned types of adjudicative proceedings, there are minimal statutory guidelines or criteria pursuant to which a final decision is to be reached. Because of the infrequency of such proceedings there has not been established, with respect to most of these matters, any large body of decisional precedent upon which a subordinate officer could rely for guidance. The applicable statutes grant the Board broad discretion, and the issues involved go substantially beyond the mere application of facts to statutory criteria. In such circumstances, the Board believes that to place in a subordinate officer the final decision in cases of adjudication, with very limited opportunity for agency review under Sec. 8(c)(4), could be prejudicial both to the respondents in such cases and to the Board's effectiveness as a statutorily constituted regulatory and supervisory body.

Accordingly, the Board favors retention of the provisions of Sec. 8(a) of the APA pursuant to which a presiding officer makes a recommended decision, upon review of which the agency issues the initial decision.

In respect to the provisions of Sec. 8(c) of S. 1336 calling for the establishment by each agency of one or more appeal boards, the Board favors the functional purposes to be served by such establishments.

However, the following comments are offered for consideration in respect to certain of the provisions relating to the establishment of these appeal boards.

The Board recommends that ultimate authority to grant oral argument during the proceedings before an appeal board be placed in the discretion of the agency. Sec. 8(c)(2) would grant oral argument in any case upon request of a party. Provision is made in Sec. 8(b) for the opportunity, in the discretion of the presiding officer, for oral argument in support of proposed findings and conclusions. Presumably, the instances would be infrequent where oral argument thus requested would be denied. To accord parties an absolute right of oral argument before an appeal board would, in the Board's judgment, introduce an element of delay in the total administrative process that would not be compensated for by any significant benefit to the party or to the agency involved. The rights of parties appearing before an agency appeal board would not appear to be prejudiced in any manner by giving to that appeal board a discretionary judgment in respect to granting oral argument.

The provision in Sec. 8(c)(2) whereby a private party could avoid consideration and determination by the appeal board of exceptions to a presiding officer's decision or rulings appears to render nearly useless the functions intended to be performed by the appeal board. Under the proposed provision a private party may avoid consideration by the appeal board merely by filing an application for a determination

of exceptions by an agency - a procedure identical to that where an agency has not established an appeal board. It is believed that agency determination of exceptions raised by a party should be limited to those cases where the agency has not established an appeal board.

Regarding the grounds upon which an agency may order a particular case brought before it for review, Sec. 8(c)(4) limits such grounds to (1) decisions or actions that may be contrary to law or agency policy; (2) to cases as to which the agency wishes to reconsider its policy; or (3) to cases as to which a novel question of policy has been presented. The Board would be unopposed to these provisions only if its recommendations relating to retention of the APA's recommended decision procedures are adopted. If S. 1336 were to provide that an agency may by rule designate a case in which the agency itself may make the initial decision following a recommended decision by a presiding officer, the appeal and review procedures proposed in S. 1336 would not be objectionable since the agency would have control over the class of cases as to which it would delegate initial decision authority to the presiding officer. Absent retention of the recommended decision feature of the APA, the Board strongly recommends that S. 1336 contain a provision giving an agency the authority to consider de novo any issue involved in a case appealed to or reviewed by the agency after entry of the decision of the presiding officer or after the action of an appeal board.

Sec. 9 - Sanctions and Powers

The Board favors the provision of Sec. 9 that would impose on every agency, in respect to any proceeding required to be conducted pursuant to S. 1336 or otherwise required by law, a duty to set and complete such proceedings "with reasonable dispatch". Such requirement is at present specifically applicable only to licensing proceedings conducted pursuant to Secs. 7 and 8 of the APA.

Sec. 9(b) provides that any publicity issued by an agency or officer, employee, or member thereof, that is found by a court to have been issued to discredit or disparage a person under investigation or a party to an agency proceeding, may be held to be a prejudicial prejudging of the issues in controversy and to constitute a basis for court action in setting aside any agency action against such person or party.

In the Board's judgment, the inclusion in S. 1336 of the proposed language relating to agency publicity offers a greater potential for misunderstanding and confusion than for any remedial benefit that might be derived therefrom.

Should it be deemed necessary to provide specifically for the right of a reviewing court to set aside adverse agency action which is shown to have been preceded by a prejudicial prejudgment of the issues in controversy, such a provision could be added as a seventh category of agency actions which, as required by Sec. 9(e)(B), a reviewing court shall "hold unlawful and set aside".

Sec. 10 - Judicial Review

The judicial review provisions of the APA are expressly inapplicable insofar as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion. Thus, two distinct criteria are now provided by which a determination can be made as to whether a particular agency action is subject to judicial review. If a statute precludes or can be interpreted as intended to preclude judicial review of particular agency action, such action is excepted from the judicial review provisions of the APA. Similarly, where the statutory provisions under which an agency purports to act either expressly or by implication commit a particular action to agency discretion, such action is not subject to judicial review.

Sec. 10 of S. 1336 would exclude from judicial review, as does the APA, agency actions as to which "statutes preclude judicial review". However, S. 1336 would narrow the existing APA provision regarding agency discretion by making the exception with respect thereto applicable only where "judicial review of agency discretion is precluded by law". In the Board's view, there is neither need nor justification for the change proposed in respect to acts committed to agency discretion. The Board believes the existing provisions of law to be unambiguous and to meet fully the apparent Congressional intent in formulating the judicial review provisions of the APA. On the other hand, the proposed language in S. 1336 relating to judicial review of discretionary agency actions can be said to be redundant in that the circumstances covered by the exception appear to be included in and

covered by the first exception of Sec. 10 relating to situations where "statutes preclude judicial review". It appears to the Board that agency discretion that is "precluded by law from judicial review" must, even under a very narrow construction, be construed as action precluded from judicial review by statute, either specifically or by reasoned deduction from the statutory context. Thus, rather than the two separate and distinct circumstances under present law that give rise to exception from judicial review, S. 1336 would provide but a single circumstance under which agency action would be excepted from judicial review, namely, where judicial review is precluded by statute.

Even assuming, arguendo, that the Board's interpretation of the preamble to Sec. 10 of S. 1336 is unduly restrictive, the Board would oppose the proposed language more broadly interpreted. Under existing law, a single determination is required under each of the two exceptions from judicial review of agency action. Judicial review is precluded (1) if so provided by statute, or (2) if agency action is by law committed to agency discretion. Pursuant to the provisions of S. 1336, a determination of whether a discretionary agency action is judicially reviewable would, in turn, require two distinct determinations. First, is the agency action in question expressly or by implication committed to agency discretion? Second, if so committed, is judicial review of such discretionary action expressly or by implication precluded by law? The Board is unable to ascertain either a need or justification for the change proposed in the existing provisions of

law. Even assuming the need for a change in the APA's provisions, the Board views Sec. 10(2) of S. 1336 as lacking in a clear, functional guide for determining agency actions that are to be excepted from the bill's judicial review provisions.

The Board finds a far more objectionable feature of the judicial review provisions of Sec. 10(2) to be that actions of the Board in the areas of credit regulation and monetary policy, including those earlier discussed relating to ratemaking, would be made subject to these judicial review provisions. Such Board actions, committed by law to the Board's discretion, are now excluded from judicial review pursuant to provisions of the APA.

The change proposed would subject the Board's judgment and action in money market and credit requirement matters to affirmation, modification, or rejection by a court upon allegation by any person that he is adversely affected by such action, notwithstanding its uniform applicability to the public at large. It is the Board's belief that irreparable and substantial harm to the economy of the nation could result were the Board deprived of final authority to take those actions in the areas of credit regulation and monetary policy that are considered necessary in the public interest. Inasmuch as enactment into law of proposed Sec. 10(2) of S. 1336 could bring about the harm described, the Board strongly urges rejection of the proposed provision and retention of the exemptions from judicial review now provided by the preamble to Sec. 10 of the APA.

The Board is opposed to the change proposed by Sec. 10(a) of the bill in regard to persons entitled to judicial review of agency action. At present, the APA gives a right of review to "any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute". Under S. 1336, the test would be merely whether a person is adversely affected by agency action. The finite concept of legal wrong and statutory definition of "adversely affected or aggrieved" would be discarded in favor of an abstract test having no perceivable limits. Thus, should the Board deny an application by a member bank for permission to establish a branch facility, under the proposed provision providing for judicial review, any resident of the town in which the proposed branch would have been located could assert that he was "adversely affected in fact" by the Board's denial action, and thus entitled to judicial review of that action.

Regarding the potential for innumerable, unwarranted petitions for judicial review, Sec. 9 of the Bank Holding Company Act of 1956 expressly provides that "any party aggrieved by an order of the Board . . . may obtain review of such order in . . . [a] United States Court of Appeals . . . ." Under Sec. 10(a) of the APA, the only "aggrieved" person in such cases would be a party to the proceeding, since this is the only person who can be "aggrieved. . . within the meaning of . . . [the] relevant statute". Pursuant to the proposed amendment under discussion, apparently not only a party to a proceeding

under the Bank Holding Company Act could seek review of the Board's action, but any other person, such as a customer of a bank involved or of a competitor, another bank holding company competing in the same area, or any one of a host of other persons who might assert themselves to be "adversely affected in fact", directly or indirectly, substantially or remotely, by the Board's action. The Board views the proposed change in the review provisions of the APA as potentially productive of circumstances that could harmfully impede the orderly and expeditious disposition of administrative matters. Accordingly, the Board strongly recommends that the standards now contained in Sec. 10(a) of the APA regarding standing to seek judicial review be retained.

The Board also urges retention of the language in Sec. 10(b) providing that that form of proceeding for judicial review "shall be any special statutory review proceeding . . . in any court specified by statute."

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

Item No. 6
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 12, 1965.

Mr. Lee J. Aubrey,
Assistant Vice President,
Federal Reserve Bank of Boston,
Boston, Massachusetts. 02106

Dear Mr. Aubrey:

This is in reply to your letter of April 12, 1965, in which you requested the views of the Board with respect to a compensating balance automobile loan plan being offered by Commonwealth National Bank, Boston, Massachusetts.

It is understood that automobile installment loan customers of the bank are charged interest computed at the rate of $4.50 per $100 initial loan balance per year, which is added to the face of the note. At the time the loan is made a cashier's check is drawn on the bank equal to 1/2 of 1% per year of the initial loan which is made payable to the order of the borrower and/or the bank and retained by the bank. When the loan is paid in full, this check is turned over to the borrower provided that he maintains a demand deposit account with the bank for an average monthly balance of $100, and pays the loan installments as they become due. If the borrower maintains a demand balance of $1,000 or more the rebate is computed at twice the above rate, or 1% per year of the actual loan. In either case, the checking account is subject to the same service charge made on all deposits.

Section 19 of the Federal Reserve Act and section 217.2(a) of Regulation Q provide that no member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand. Section 217.2(a) also provides that any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit shall be considered interest.

Based on the foregoing facts, it is the Board's view that the rebate plan being offered by Commonwealth National Bank involves a direct payment to a depositor as compensation for the use of funds

in a demand deposit. Accordingly, the rebate here involved constitutes a payment of interest on a demand deposit in violation of section 19 of the Federal Reserve Act and Regulation Q.

It is requested that you inform the Commonwealth National Bank, and The First National Bank of Boston, which we understand is considering use of a similar plan, of the Board's decision.

As the compensating balance plan here in question is being offered by a national bank subject to the supervision of the Office of the Comptroller of the Currency, a copy of this letter is being forwarded to that office for appropriate action.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 7
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 12, 1965.

Mr. G. Keith Funston, President,
New York Stock Exchange,
Eleven Wall Street,
New York 5, New York.

Dear Mr. Funston:

This is in reference to your letter of April 29, 1965, requesting that the Board of Governors reinstate the part of Published Interpretation ¶ 6040 that was withdrawn by Board action on April 19, 1965. The Board of Governors considered the points you raised prior to the withdrawal of the Interpretation. However, your interest and comments are appreciated.

As you know, the recent amendment to section 220.4(c)(3) allows a limited extension of credit for a purchase of a security issued to replace one that is outstanding by the owner of the old security. Prior to the amendment, a similar purchase could be effected without cash payment only by depositing the called or maturing security with a creditor within seven days of purchasing the new one. The deposit procedure is no longer necessary for this purpose.

Upon reconsideration, the Board has reaffirmed its decision to withdraw the relevant portion of ¶ 6040 because the deposit procedure allowed an extension of credit, with no set time restriction, for reinvestment in <u>any</u> security. The principal purpose of this exception to the rules that ordinarily govern Special Cash Accounts is to allow an investor to continue the <u>same</u> investment without the hardship of advancing new funds; the amendment allows this without permitting the injection into the securities market of credit not related to that objective.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 8
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 12, 1965.

Mr. George D. Royer, Jr., Vice President,
Federal Reserve Bank of Kansas City,
Kansas City, Missouri. 64106

Dear Mr. Royer:

This refers to copies of your letter of March 10, 1965, to Mr. H. L. Sturgeon, President, Rocky Ford National Bank, Rocky Ford, Colorado ("Bank"), of Mr. Sturgeon's reply of March 15, 1965, and of a letter to Mr. Sturgeon dated February 24, 1965, from Mr. J. R. Thomas, Regional Comptroller of the Currency, Twelfth National Bank Region, all of which you submitted to the Board in connection with the question whether section 8 of the Clayton Act ("section 8") forbids the interlocking service of Mr. Sturgeon as president of Bank and director and cashier of the First Industrial Bank of Rocky Ford ("Industrial"). Mr. W. E. Shelton, a director of Bank, is also serving as director of Industrial and the same question arises in his case.

Mr. Sturgeon makes two arguments supporting his contention that the interlocking service is permissible, (1) that he relied upon the fact that interlocking service existed for many years between Bank and the Rocky Ford Federal Savings and Loan Association, and the business of the latter resembles that of Industrial, and (2) that Industrial is not engaged in the same "class or classes of business" as Bank, hence the exception provided in the sixth paragraph of section 8, and 212.2(d)(6) of Regulation L, "Interlocking Directorates Under the Clayton Act", permits interlocking service between Industrial and Bank.

As to the first argument, section 8 does not forbid interlocking service between a bank and a Federal savings and loan association for the reason that the statute applies only to institutions which can be described as a "bank, banking association, savings bank, or trust company organized under the National Bank Act or organized under the laws of any State or of the District of Columbia." Federal savings and loan associations are not organized under any of these, but rather, under a specific Federal statute. For this reason, as footnote 3 to Regulation L points out, such associations are excepted from the prohibitions of section 8 "irrespective of whether they are 'banks' or 'banking associations' within the meaning of the statute."

By way of background in reference to the second argument, as you know, the question whether a particular financial institution is a "bank" arises under a number of the statutes which the Board is required to administer. The determination can be a close one, turning on consideration of many aspects, both as to the legal powers of the institution, and the business actually done by it. In its interpretation published at 1963 Federal Reserve Bulletin 165, the Board stated that ". . . taking into account the spirit and purpose of the (Bank Holding Company) Act (of 1956), industrial banks are not within the purview of the term 'State bank' . . ." unless the circumstances of the particular case indicate otherwise. In arriving at that conclusion, the Board was influenced by legislative history indicating that the Bank Holding Company Act " . . . was directed principally at control of 'commercial' banks, and . . . that 'industrial banks', as that term is usually understood, were not regarded as being engaged in commercial banking."

The Board has on many occasions held industrial banks to be "banks" for purposes of section 8 of the Clayton Act. During the period before the 1935 amendments when the Board had authority to grant permits for interlocking service, but only to grant such permits with respect to banking institutions, the Board concluded that Morris Plan banks (which are similar to industrial banks) were "banks" for purposes of the statute. Since those amendments, the Board on frequent occasions has concluded that industrial banks were "banks" within the meaning of section 8. In a letter of August 2, 1940, for example, addressed to the Kansas City Reserve Bank, the Board said that the First Industrial Bank of Denver, Denver, Colorado, was a "bank" for this purpose.

The Board's interpretation of October 19, 1939 (F.R.L.S. # 7724, S-189-a), that a particular Morris Plan company was not a bank, illustrates the criteria relied on to determine whether an individual institution is a "bank" for purposes of section 8. Among the factors stressed were that the statutes under which the company was organized made it unlawful for it to call itself a "bank", "savings bank" or "trust company". The company sold fully paid investment certificates (as distinguished from certificates issued in connection with a loan), but only in denominations of fifty dollars or multiples thereof, and although it redeemed such certificates on demand, apparently restricted redemptions requiring, for example, except in emergency, that the certificate be presented at the office of the company and physically signed over to it. Moreover, the actual number of redemptions, and the total dollar amount involved, was very small in relation to the balance of the business done by the company, nor did the company ". . . maintain any form of so-called checking account service . . . ."

In reaching its decision in that case, the Board believed it to be a rather unusual one. By contrast, the Board's letter of January 8, 1940 (F.R.L.S. # 7725, S-198), described a more usual type of institution, organized under a State statute providing for the organization of industrial loan corporations, which it considered to be a "bank" within the meaning of section 8. This institution was authorized to receive deposits, and did in fact have savings accounts consisting of deposits received under rules that were substantially the same as those used by commercial banks receiving savings deposits.

If, as seems probable, Industrial resembles the institutions described in the Board's letters of August 2, 1940 and January 8, 1940, then it would similarly be a "bank" for purposes of section 8, and interlocking service between Bank and Industrial would fall within the prohibitions of that section, unless otherwise excepted, as you pointed out in your letter to Mr. Sturgeon of March 10, 1965. This conclusion, of course, would necessarily rest, in part at least, on Industrial's receiving deposits which were substantially similar to savings deposits received by commercial banks. For this reason, the exception provided by paragraph (6) of section 8 and by section 212.2(d)(6) of Regulation L would not be applicable, since both Bank and Industrial would be engaged in the second class of business listed in reference to the exception in footnotes 9 and 14 to the regulation, i.e., "receiving savings deposits". It should be noted also that the seventh class of business listed in the same footnotes is "making 'personal' loans of the character usually made by Morris Plan or Industrial banks". It is assumed that Bank and Industrial both make loans of this character.

It would be appreciated if you would review the situation in the light of this letter and advise Mr. Sturgeon accordingly.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 9
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 12, 1965.

Mr. W. L. Cooper, Assistant General Counsel,
Federal Reserve Bank of San Francisco,
San Francisco, California. 94120

Dear Mr. Cooper:

This refers to your letter of March 12, 1965, to Mr. Hackley, with enclosures, as well as to your correspondence and discussions with Mr. Hackley over the preceding months, in connection with a request by the securities firm of Wheeler, Munger & Co., Los Angeles, California ("Wheeler"), for an interpretation by the Board as to whether the firm is primarily engaged in activities described in section 32 of the Banking Act of 1933 ("the Act"). If Wheeler is so engaged, then the prohibitions of the Act forbid a limited partner in the firm to serve as employee of United California Bank, Los Angeles, California, a member bank.

Wheeler describes the bulk of its business, producing roughly 60 per cent of its income, as "investing for its own account". However, it has a seat on the Los Angeles branch of the San Francisco exchange, and acts as specialist and odd-lot dealer on the floor of the exchange, an activity responsible for some 30 per cent of its volume and profits. The firm's "off-post trading", apart from the investment account, gives rise to about 5 per cent of its total volume and 10 per cent of its profits. Gross volume has risen from $4 to $10 million over the past three years, but underwriting has accounted for no more than one-half of one per cent of that amount.

As you know, section 32 provides that

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

In interpreting this language, the Board has consistently held that underwriting, acting as a dealer, or generally speaking, selling or distributing securities as a principal, is covered by the section, while acting as broker or agent is not.

In one type of situation, however, although a firm has been engaged in selling securities as principal, on its own behalf, the Board has held that section 32 did not apply. In these cases, the firm alleged that it bought and sold securities purely for investment purposes. Typically, these cases have involved personal holding companies or small family investment companies. Securities have been purchased only for members of a restricted family group, and have been held for relatively long periods of time. The question before the Board is whether a similar exception can apply in the case of the investment account of a professional dealer.

In order to answer this question, it is necessary to analyze, in the light of applicable principles under the statute, the three main types of activity in which Wheeler has been engaged, (1) acting as specialist and odd-lot dealer, (2) off-post trading as an ordinary dealer, and (3) investing for its own account. On several occasions, the Board has held that, to the extent the trading of a specialist or odd-lot dealer is limited to that required for him to perform his function on the floor of the exchange, he is acting essentially in an agency capacity. In a letter of September 13, 1934, the Board held that the business of a specialist was not of the kind described in the (unamended) section on the understanding that

> ". . . in acting as specialists on the New York Curb Exchange, it is necessary for the firm to buy and sell odd lots and . . . in order to protect its position after such transactions have been made, the firm sells or buys shares in lots of 100 or multiples thereof in order to reduce its position in the stock in question to the smallest amount possible by this method. It appears therefore that, in connection with these transactions, the firm is neither trading in the stock in question nor taking a position in it except to the extent made necessary by the fact that it deals in odd lots and cannot complete the transactions by purchases and sales on the floor of the exchange except to the nearest 100 share amount."

While subsequent amendments to section 32 to some extent changed the definition of the kinds of securities business that would be covered by the section, the amendments were designed, so far as is relevant to the present question, to embody existing interpretations of the Board. Accordingly, to the extent that Wheeler's business is described by the above letter of the Board, it should not be considered to be of a kind described in section 32.

Turning to the firm's off-post trading, the Board is inclined to agree with your view that this is sufficient to make the case a borderline one under the statute. In the circumstances, the Board might prefer to postpone making a determination until figures for 1965 could be reviewed, particularly in the light of the recent increase in total volume, if it were not for the third category, the firm's own investment account.

While this question has not been squarely presented to it in the past, the Board is of the opinion that when a firm is doing any significant amount of business as a dealer or underwriter, then investments for the firm's own account should be taken into consideration in determining whether the firm is "primarily engaged" in the activities described in section 32. The division into dealing for one's own account, and dealing with customers, is a highly subjective one, and although a particular firm or individual may be quite scrupulous in separating the two, the opportunity necessarily exists for the kind of abuse at which the statute is directed. The Act is designed to prevent situations from arising in which a bank director, officer, or employee could influence the bank or its customers to invest in securities in which his firm has an interest, regardless of whether he, as an individual, is likely to do so. In the present case, when these activities are added to the firm's "off-post trading", the firm clearly falls within the statutory definition.

For the reasons just discussed, the Board concludes that Wheeler must be considered to be primarily engaged in activities described in section 32, and that the prohibitions of the section forbid a limited partner in that firm to serve as employee of a member bank. It would be appreciated if you would communicate the substance of this letter to Wheeler.

Very truly yours,

Merritt Sherman,
Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 10
5/12/65

OFFICE OF THE VICE CHAIRMAN

May 14, 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 April 5, 1965, and its enclosure, in which you referred to the decision of the Federal District Court on March 10, 1965, that the merger of Manufacturers Trust Company and The Hanover Bank, which had been approved by the Board under the Bank Merger Act in September 1961, violated the Federal antitrust laws. You stated that you are "concerned with the grave problems which can arise in bank merger cases, where the stamp of approval has been affixed by a banking agency, only to have it destroyed at some future time through the efforts of another agency of the Government, the Antitrust Division".

Your letter asked whether such situations could be avoided under existing law, and for views and suggestions for dealing administratively with the problem.

The Board's Rules of Procedure deal specifically with those bank mergers required by the Bank Merger Act of 1960 (12 U.S.C. 1828(c)) to have the prior approval of the Board. Since November 1, 1961, these Rules have barred consummation of any merger, except in special situations, until seven days have elapsed after public release of the Board's Order approving the transaction. (12 CFR 262.2(f)(5)) For convenient reference, a copy of the Board's Rules of Procedure is enclosed. Although not required by any statute, this provision of the Rules was adopted to reduce the prospects of having to unscramble a merger that, subsequent to its approval, was made the subject of litigation under the Federal antitrust laws. The Department of Justice, of course, is assured specific advance notice of pending merger applications under the requirement in the Act for advisory reports on competitive factors from

the Attorney General. This requirement in the Act, in turn, assures to the appropriate Federal bank supervisory agency the benefit of the background and experience of the Department with respect to competition and antitrust matters.

The Board gives very careful consideration to the advisory reports of the Attorney General, as well as to those of the other two Federal banking agencies, in determining whether to approve or disapprove a particular transaction. As indicated in the enclosure with the Board's letter of May 1, 1963, to you, the Antitrust Division occasionally asks for more information with respect to particular merger applications, and this information is obtained and supplied. In some cases where the Board has received additional information regarding an application after transmittal of requests for competitive factors advisory reports, the Board has requested a further expression of views from the other banking agencies and the Attorney General in the light of such additional information. Furthermore, as experience has developed under the Act over the years, there has been informal discussion between the staff of the Board and the staff of the Attorney General where the Antitrust Division has had serious question under the antitrust laws regarding a particular proposal and the desirability of such discussion has been indicated.

The merger of Manufacturers Trust Company and The Hanover Bank - which was a matter covered in the enclosure with the Board's letter of May 1, 1963, mentioned above - is the only one approved by the Board under the Bank Merger Act that has been the subject of litigation under the antitrust laws. In its letter to you of April 17, 1964, the Board stated that, to its knowledge, there had been no situation with respect to any merger application processed by the Board since the landmark decision in June 1963 in the Philadelphia National Bank case (374 U. S. 321) that had indicated a need for any change in the Board's procedures relative to the functions of the Attorney General and the courts under the antitrust laws. This is true also as of now.

However, while the seven-day provision in the Board's Rules or other procedures of the kinds mentioned may render unlikely antitrust litigation to upset a merger previously approved by the Board or the task of unscrambling the merger, they cannot effectively preclude such possibilities. The Philadelphia National Bank case, the First National Bank and Trust Company of Lexington case in April 1964 (376 U. S. 665), and the Manufacturers-Hanover decision of last March

emphasize that court proceedings to enforce the antitrust laws as to bank mergers are not barred by the prior approval of the mergers by the appropriate Federal bank supervisory agencies under the Bank Merger Act, and there appears to be no Federal statute of limitation on actions to enforce the antitrust laws.

There can be no doubt that recent court decisions involving bank mergers have applied the antitrust laws in circumstances in which the Congress understood they would not apply when it passed the Bank Merger Act of 1960, as indicated to you in the Board's letter of April 17, 1964. It is clear from the legislative history of the Bank Merger Act that the Congress understood that there would be situations in which "approval of the merger would be in the public interest, even though this would result in a substantial lessening of competition." (S. Rpt. No. 186, April 17, 1959, pp. 19-24; H. Rpt. No. 1416, March 23, 1960, pp. 10-13) That legislative history makes it abundantly clear also that the Congress did not believe the public interest would be served best if the legality of bank mergers were to be tested by competitive or antitrust factors alone, to the exclusion of banking factors, including offsetting benefits to the public.

Recent court decisions applying antitrust laws to bank mergers have underscored the difference in approach in the antitrust field, where the effect on competition is given virtually controlling weight. Thus, there is a conflict between the job of the Federal banking agencies under the Bank Merger Act and the function of the Attorney General and the courts under the antitrust statutes. Under the Bank Merger Act the Board must consider both banking factors and competitive factors in acting upon bank merger applications. The Board knows of no administrative steps that can be taken appropriately under existing law that would effectively bar actions pursuant to the antitrust laws to upset bank mergers previously approved by one of the Federal bank supervisory agencies under the Bank Merger Act.

Although your letter made no reference to possible legislative measures to correct the situation that seems to have prompted your inquiry, the Board nevertheless has taken the liberty of enclosing a copy of its report to the Senate Committee on Banking and Currency on the bill, S. 1698, which would amend the Bank Merger Act to exempt bank mergers from the Federal antitrust laws.

You will note that the Board's report on S. 1698 urges enactment of such legislation. The Board's report also mentions the possibility of some other approach to the problem should the Congress be unable to agree on the approach proposed in S. 1698. As the report points out, one such possibility would be to amend the Bank Merger Act to allow a specified time necessary for the filing of an antitrust action in court to prevent consummation of an approved transaction, after which, in the absence of such an action, the merger could be consummated and would be exempt from the antitrust laws.

Sincerely yours,

(Signed) C. Canby Balderston

C. Canby Balderston,
Vice Chairman.

Enclosures.

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

Item No. 11
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 13, 1965

Mr. Howard D. Crosse, Vice President,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Crosse:

In accordance with the request contained in your letter of May 7, 1965, the Board approves the appointment of Franklin T. Love as an assistant examiner for the Federal Reserve Bank of New York. Please advise the effective date of the appointment.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 12
5/12/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 13, 1965

Mr. George D. Royer, Jr., Vice President,
Federal Reserve Bank of Kansas City,
Kansas City, Missouri. 64106

Dear Mr. Royer:

In accordance with the request contained in your letter of May 6, 1965, the Board approves the appointment of Philip Edgar Schmidt as an assistant examiner for the Federal Reserve Bank of Kansas City. Please advise the salary rate and the effective date of the appointment.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.