Minutes for May 19, 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 WMM

Gov. Robertson R

Gov. Balderston CCB

Gov. Shepardson

Gov. Mitchell

Gov. Daane

Gov. Maisel SJM

Minutes of the Board of Governors of the Federal Reserve System on Wednesday, May 19, 1965. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Robertson
Mr. Shepardson
Mr. Mitchell
Mr. Maisel

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Noyes, Adviser to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Holland, Associate Director, Division of Research and Statistics
Mr. Partee, Adviser, Division of Research and Statistics
Mr. Dembitz, Associate Adviser, Division of Research and Statistics
Mr. Langham, Assistant Director, Division of Data Processing
Mrs. Semia, Technical Assistant, Office of the Secretary
Mr. Sanders, Senior Attorney, Legal Division
Mr. Gedanken, Statistician, Division of Data Processing

Float (Item No. 1). There had been distributed a draft of reply to a letter dated April 1, 1965, from Chairman Fascell of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations asking that the Board bring up to date its previous comments regarding float, particularly in the light of increased use of automatic data processing equipment in check clearings. The letter also requested information regarding the relationship between float and possible changes in reserve requirements of member banks, the relationship between float and the Federal funds market, and possible benefits to be derived if reserve computation periods were put on a monthly basis.

The first part of the draft reply would report that from 1963 to 1964 the total number of checks handled by the Reserve Banks rose 6 per cent; the volume of checks handled on automatic equipment rose from 23 per cent of the total to 53 per cent; and the daily average of total float rose about 8 per cent. However, daily average holdover float decreased from $488 million in April 1963 to $227 million in April 1965, largely as a result of the increased use of automatic equipment.

Mr. Farrell, in commenting on this part of the draft reply, noted that in a letter to Chairman Fascell of March 13, 1964, in response to his question as to what circumstances made it inappropriate at that time to change the maximum deferment for check credits from two to three days, the Board had listed three considerations: additional sorting work by member banks, the effect on holdover float, and the possible effect on credit and money market developments. The Board's letter had commented that "At such time, however, as the Federal Reserve Banks are able to process most of their check volume on high-speed equipment, it should be possible to change the deferment schedule without requiring member banks to make an additional sort, and perhaps to reduce the number of sorts the member banks would have to make even though the deferment schedule were changed." That letter also pointed out that "The hope of reducing holdover float depends in large measure on the continued cooperation of commercial banks. This cooperation might not be so readily forthcoming if member banks were now burdened with the requirement of an additional sort of checks they presented for payment through the Federal Reserve Banks."

In view of the increase to 53 per cent in the volume of checks processed automatically, Mr. Farrell continued, some action might appear to be indicated soon to reduce float by extending the maximum deferment to three days. However, even though the halfway mark had now been reached, other considerations might point to the desirability of attaining a higher percentage before such a change was made.

Mr. Holland commented that the last three questions in Chairman Fascell's current inquiry had been rather awkward to handle, since in the judgment of the Board's staff float was only incidental to the other factors involved. An attempt nevertheless had been to draft replies in as straightforward a fashion as possible.

Governor Robertson expressed the view that the draft reply was designed merely to hold the place and offer an excuse for doing nothing. With the volume of checks processed automatically having increased from 23 to 53 per cent of the total, the increase in the volume of checks handled was not sufficient explanation for an 8 per cent increase in daily average float. Moreover, there was no satisfactory explanation why, although the majority of checks were now processed automatically, there was still no action to change the deferment schedule. The inquiries of the Legal and Monetary Affairs Subcommittee had stemmed from a concern that float represented windfall reserves to member banks, and it was inescapable that if member banks obtained similar reserves through the discount window they would have to pay for them.

Mr. Farrell observed that the parent Committee on Government Operations was charged with responsibility for studying the efficiency of operations of Government departments and agencies, which gave rise to an inquiry from the Subcommittee some time ago as to whether a saving to the Government would not result if maximum deferment was increased from two to three days, with a consequent decrease in float and with a consequent necessity for member banks to borrow to obtain the reserves they now derived from float. The Board had responded, in essence, that the reserves deemed necessary for implementation of monetary policy would have to be supplied one way or another, and it would depend upon the method chosen to supply them whether or not a change in the volume of float would have any effect on the payments to the Treasury out of Reserve Bank income. It had been pointed out that the level of member bank reserves was a matter of monetary policy and the Federal Reserve's choice of the method of implementing policy would not depend upon the effect of the action on payments to the Treasury. The change in maximum deferment from three to two days had been made in 1951, Mr. Farrell continued, in the expectation that improved check-handling procedures would offset the reduction in maximum deferment. However, this expectation had not materialized. Therefore, one might question why something had not been done to reverse an action that developments failed to justify. In 1958 the Presidents' Conference and the Board considered the matter at some length, but no action was taken on the deferment schedule.

Governor Robertson proposed that the Board establish a committee to make a fresh appraisal of the problem. He suggested that Governors Daane and Maisel be asked to serve on such a committee.

In response to a question by Governor Balderston as to the contemplated boundaries of the proposed study, Governor Robertson suggested that the committee have complete freedom to proceed afresh without limiting instructions.

Mr. Farrell remarked that it might be well to bear in mind the possibility of overlap between the work of such a committee and the comprehensive review of the check collection mechanism that was currently being made by the Presidents' Conference.

Governor Mitchell expressed the view that the ultimate solution to the float problem lay in immediate charge and immediate credit; and there ensued a general discussion of the implications of adoption of such a procedure together with technical difficulties that would have to be overcome.

Governor Balderston recalled that at one time he had been inclined to feel that the System ought to move back to three-day maximum deferment. However, he had been concerned about the bank and public relations problems involved in such a move. Likewise, some of the Reserve Bank Presidents were deeply concerned, even though they were sympathetic to the logic of the longer maximum deferment. At the present time, Governor Balderston pointed out, check collection processes were still in a period of transition, and a change to three-day maximum deferment might have disruptive effects. It had been hoped that increased automation would reduce float, and to some extent this hope was being realized, for it now appeared that substantial progress was being made in reducing holdover float.

Governor Robertson remarked that the draft letter did not mention the continued existence of the transition period, which he regarded as the only valid reason that could be given for not reverting to three-day maximum deferment.

Governor Maisel observed that certain passages in the draft letter regarding the relationship between float and changes in reserve requirements lacked clarity. Also, if the Subcommittee was sophisticated enough to look into the possibility that a reduction in float might result in greater payments to the Treasury, it surely must also have in mind the question of redistribution of income among banks stemming from sales of Federal funds by banks that had excess reserves generated by float.

Mr. Farrell replied that the Subcommittee's major concern, to judge from conversations with its staff, centered on the contention that float provided windfall reserves to member banks. Some corollary interest had been indicated, however, in whether the continuance of a high level of float had overtones of favoring larger banks, which, according to one school of thought, were the principal beneficiaries of reserves derived from float.

After further discussion of various points that were raised, approval was given to a letter to Chairman Fascell in the form attached as Item No. 1.

The discussion then reverted to Governor Robertson's suggestion that a committee be appointed to make a float study. In response to inquiries from Governor Balderston, Governor Robertson indicated that he envisaged a committee of two members of the Board to direct the study, with such staff help as needed, and with Reserve Bank personnel brought in for whatever consultation might be desired but not for membership on the committee.

Governor Shepardson concurred with the suggestion that a new look be taken. He had come more and more to question the philosophy followed in the past. What new approach might be best, he did not know, but he thought the various possibilities should be explored.

Governor Mitchell suggested that it would be a good idea first to prepare a document describing the issues involved. In the light of that document, he might favor a committee study, but at present he was not sure that the objectives of such a study were sufficiently clear.

Governor Maisel said that he would go along with the proposal for a study, while Governor Balderston commented that he believed it might be well to arrive at some definition of objectives.

Governor Robertson then suggested, as a compromise approach, that the first task of the committee be to direct the preparation for the Board of a background document, on the basis of which the committee's assignment could be specified.

There was general agreement with this suggestion.

Mr. Dembitz then withdrew from the meeting.

Data on compensation of bank officers (Item No. 2). There had been distributed a memorandum dated May 17, 1965, from Mr. Langham regarding further developments relating to a request from the House Banking and Currency Committee for bank officers' compensation data. The data were sought in connection with the Committee's study of management succession, which was being directed by Professor Donald Jacobs, and were to be taken from examination reports. In a letter of August 9, 1963, in response to a request of the Committee regarding the study, the Board stated that the information requested would be supplied in such form as would obviate any possibility of disclosure or identification of individual banks and officers, and that the figures would be tabulated according to classifications agreed upon by the staffs of the Committee and the

Board. Professor Jacobs' specifications of the data needed on bank officer compensation were set forth in Mr. Langham's memorandum of September 24, 1964. It was contemplated that the tables prepared pursuant to such specifications would be analyzed, that there would be a masking of any results that represented figures for fewer than three banks, and that only tabulations thus edited would be turned over to Professor Jacobs. The Board approved the request on that basis on September 28, 1964.

Mr. Langham's memorandum of May 17, 1965, reported that the specifications required more detail than anticipated, and as a result many of the tables showed information pertaining to individual banks. In addition, a series of tables for the New York consolidated area, which included only 169 banks, contained such detailed information that Mr. Langham recommended against their being furnished. Professor Jacobs, upon being informed of this development, had agreed that the New York tables were not essential to the successful completion of his study.

Examples of the information shown by certain tables were set out in the memorandum. Even though there were numerous instances in which information for single banks was shown separately, it was believed that in none of these cases could the identity of a bank be disclosed without additional information. Thus, there appeared to be little danger of confidentiality violations in the publication of the tables. However, it was suggested that it might be desirable to avoid publication in such detail as to show cells containing only one or two banks.

The memorandum concluded by suggesting as alternatives that the Board (1) decline to furnish the tables to the Committee; (2) furnish the tables with no restrictions (but exclude the New York area); (3) make the data available with the understanding that any publication of them would show an asterisk in any cell containing less than three banks, with an explanatory footnote; or (4) withhold all tables showing actual numbers of banks but furnish all tables showing percentage distributions of banks.

At the conclusion of a discussion of the several alternatives, it was agreed that the complete information, including that for the New York area, would be furnished to Professor Jacobs for purposes of his analytical work, but with a restriction against publication of the New York data and a restriction against publication of other data along the lines contemplated by the third alternative mentioned in Mr. Langham's memorandum. A copy of the letter subsequently sent to Chairman Patman is attached as Item No. 2.

Messrs. Holland, Langham, and Gedanken then withdrew from the meeting.

Underwriting of securities by banks (Item No. 3). There had been distributed a memorandum dated May 17, 1965, from the Legal Division regarding requests made by Congressman Reuss during testimony by Governor Balderston before the House Banking and Currency Committee on April 26, 1965, on H. R. 7539, a bill that would authorize revenue bond underwriting by banks.

H. R. 7539, like various bills that had preceded it, sought to clear away the present confusion as to the extent to which member banks could deal in and underwrite securities. In the Banking Act of 1933, Congress had divorced banks from the securities business, but had provided an exception under which they could underwrite and deal in general obligations, that is, those supported by the full faith and credit of a State or local government having taxing power. The Board had always interpreted that exception literally and as not including revenue bonds. The Comptroller of the Currency, however, in 1963 issued an interpretation that in effect held that national banks could underwrite certain types of revenue bonds. National banks and State member banks were therefore subject to differing rules.

In statements before the House Banking and Currency Committee in 1963 Chairman Martin expressed an adverse position on permitting banks to underwrite revenue bonds; he commented that "the Board believes, moreover, that the principle of separation of commercial banking from investment banking (including underwriting and dealing) . . . is a sound and significant one." The Board's Annual Report for 1964 expressed continuing concern as to the existing confusion, referred to the Board's adverse attitude toward previous proposals for liberalizing the law, and recommended legislation that would reaffirm and clarify existing law that forbade member banks to underwrite or deal in revenue bonds.

Mr. Reuss had suggested that the problem of conflicts of interests might be avoided by an amendment to H. R. 7539, which he requested that Governor Balderston have the Board's legal staff prepare, designed (1) to prohibit a bank from purchasing, for any of its trust accounts, securities that it was underwriting; (2) to prohibit a bank from selling such securities to its borrowers or correspondent banks; and (3) to require all sales of such securities to be preceded by disclosure of the bank's position as underwriter.

Attached to the memorandum was a draft of such an amendment, similar to one furnished Mr. Reuss prior to the decision of the Committee on April 27, 1965, to table the bill (H. R. 7539). Mr. Reuss had also asked that comments on the draft amendment be submitted, and a draft of such comments was attached to the memorandum.

Governor Balderston commented on the background of the request and remarked that, since it appeared probable that the bill would not be revived, the material to be sent to the Committee apparently would serve little purpose except to complete the record.

Governor Robertson said that, as the Board knew, he did not agree with the premise that there was a greater potential for conflict of interest in underwriting revenue bonds than there was in underwriting general obligations. He would personally favor permitting banks to underwrite all types of public issues, but draw the line at underwriting private corporate issues.

Governor Shepardson stated that he had no specific comments on the material proposed to be sent to the Committee, but that generally speaking he leaned toward Governor Robertson's position. Both revenue bonds and general obligations presented opportunities for self-dealing and possibilities of conflicts of interest.

Governor Mitchell remarked that he too believed that revenue bonds and general obligations ought to be treated alike. The only reasonable objection that he saw to H. R. 7539 was the conflict of interest argument. In his view, it would be better to let banks underwrite and deal in both general obligations and revenue bonds (but not private issues) than to throw up barriers against their underwriting and dealing in general obligations, which he judged was what the amendment prepared at the request of Congressman Reuss would do.

Governor Maisel commented that it was not clear to him whether the provisions of the Reuss amendment were intended to apply to underwriting and dealing in general obligations, as well as revenue bonds.

Mr. Hexter replied that the draft comments related to the amendment that would implement Mr. Reuss's suggestion to permit banks to underwrite revenue issues but at the same time to exclude them from certain activities that might involve conflicts of interest. Banks would not be barred from underwriting either revenue bonds or general obligations, but in the areas in which conflicts of interest were involved the prohibitions contained in the Reuss amendment would be applicable to both general obligations and revenue bonds. In practice, these prohibitions might be quite restrictive on underwriting and dealing in general obligations.

There ensued comments by several Board members on whether the draft amendment and the comments thereon should relate to transactions in revenue bonds alone or in both revenue bonds and general obligations. The key language in the draft amendment seemed to be "no association that is engaged in underwriting such obligations (including general obligations of a State or a political subdivision thereof)" preceding the specification of restrictions. Staff comments indicated that the circumstances in which the draft amendment was requested were somewhat confusing. The Legal Division had considered that it probably should apply to both types of obligations, but it would be possible to delete the parenthetical expression, and thus permit commercial banks to do what they presently did with respect to general obligations, and relate the restrictions to revenue bonds only.

Governor Balderston observed that this would not be entirely consistent with the position expressed by the Board in its Annual Report for 1964. However, it could be said that Congress itself had provided an exception to permit banks to underwrite general obligations. He would not want to see that exception broadened except within limits such as the draft amendment would specify. He saw no necessity to prevent banks from continuing the business they were now doing with respect to general obligations, but he did see some reason to guard against potential abuses with respect to the numerous issues of revenue bonds. Although the immediate question related only to completing the record of the hearing, the basic issue would come up again.

The foregoing comments by Governor Balderston led to further observations by members of the Board on the position that should be taken with respect to underwriting and dealing in revenue bonds by commercial banks.

During this discussion Governor Robertson reiterated that he could not draw a distinction in his own mind, from the standpoint of potentialities for conflicts of interest, between general obligations and revenue bonds. The point of conflict of interest was involved in both cases. The draft amendment had been suggested by Congressman Reuss, so the proposed comments appeared to relate solely to the draft amendment. In these comments the staff had pointed out the difficulties of the proposed amendment, so he would not object to the comments being submitted.

Governor Mitchell inquired whether the comments on the Reuss amendment should not be regarded as staff comments, and Mr. Sanders read from the portion of the hearing record in which the request for a draft amendment and for comments thereon was made. Governor Robertson then suggested that Governor Balderston send the proposed document as a memorandum of staff comments on the points covered in the Reuss amendment.

Governor Maisel expressed agreement with the procedure suggested by Governor Robertson. He noted, however, that the concluding paragraph of the memorandum of comments was confusing because it seemed to ignore the fact that banks were already active in the field of underwriting and dealing in general obligations. It was stated that this was unintentional and that the language would be changed to clarify the point.

Governor Maisel then made the comment that personally he would not have been opposed to the objective of H. R. 7539. He added that it was his impression that comments on the Reuss amendment had been requested of Governor Balderston rather than the Board.

Another point of possible confusion in the language of the proposed comments was mentioned, and it was understood that alternative language would be used.

Governor Balderston then observed that with such changes he gathered there would be no objection to his sending the memorandum of comments on the proposed Reuss amendment.

There being no indication to the contrary, it was understood that Governor Balderston would send a letter to the Chairman of the House Banking and Currency Committee transmitting the draft of amendment reflecting the suggestion of Congressman Reuss and also transmitting his comments thereon. It was also understood that Governor Balderston would send a copy of the draft amendment to the Comptroller of the Currency, in accordance with a request made by Congressman Reuss at the time of the hearing, and that a copy of the comments thereon likewise would be sent to the Comptroller. Attached as Item No. 3 is a copy of the letter, with enclosures, subsequently sent by Governor Balderston to Chairman Patman.

Governor Balderston reverted at this point to the question of the Board's basic position on legislation that would authorize commercial banks to underwrite and deal in revenue bonds. He observed that a difference of opinion had existed within the Board for some time and that there appeared to be a question as to what the majority position would be if the issue should come up again at a time when all of the members of the present Board were in attendance. The testimony that he had presented was intended to reflect the position expressed in the Board's Annual Report for 1964, which in turn was consistent with the position previously expressed in testimony by Chairman Martin.

Governor Mitchell referred to the concern expressed in the Annual Report, and in Governor Balderston's testimony, about the advantage enjoyed by national banks over State member banks by virtue of the Comptroller's ruling permitting national banks to engage in underwriting certain revenue bonds, and he inquired whether there now appeared to be any prospect for a change in that situation. Governor Balderston replied that according to the Board's Legislative Counsel there appeared to be no immediate prospect for a change in the situation.

All members of the staff except Messrs. Sherman and Brill then withdrew from the meeting.

Assignment for Mr. Partee. After discussion based on a memorandum from Mr. Brill dated May 17, 1965, the Board authorized the nomination to the Treasury and State Departments of J. Charles Partee, Adviser in the Division of Research and Statistics, as U.S. representative on a working group of the Organization for Economic Cooperation and Development's Committee on Invisibles Transactions that was to study and report on proposals to improve the transformation of saving by financial intermediaries. In this connection, the Board authorized Governor Shepardson to approve such foreign travel by Mr. Partee as might be occasioned by this assignment.

Since Mr. Partee had been heading up the Board's staff work on the voluntary foreign credit restraint effort as it related to nonbank financial institutions, it was understood that Mr. Brill would present suggestions for Governor Robertson's consideration to supplement staff resources in this area.

Foreign travel by Mr. Young. The Board authorized foreign travel by Ralph A. Young, Adviser to the Board and Director, Division of International Finance, to accompany Governor Balderston to the annual meeting of the Bank for International Settlements, to be held in Basle, Switzerland, in June, and to undertake such other official business, including visits to central banks, as might develop in connection with this trip.

The meeting then adjourned.

> Secretary's Notes: A letter was sent today to the Federal Reserve Bank of San Francisco confirming that if Bank of America National Trust and Savings Association, San Francisco,

California, should request an extension of time to establish branches in Vienna, Austria; Tegucigalpa, Honduras; Antwerp, Belgium; and Lima, Peru, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), would be applicable. (The Board's consent to the establishment of the branches was contained in letters dated July 21, 1964, January 6, January 14, and April 12, 1965.)

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

Memorandum from the Division of International Finance dated May 18, 1965, recommending that Yves Maroni, Senior Economist in that Division, be authorized to remain in Santiago, Chile, until May 27, 1965, in connection with the assistance being rendered to the Central Bank of Chile in the formulation of consumer credit controls. In addition, the foreign travel authorization of Clarke L. Fauver, Assistant to the Board, was extended from June 12 to on or about June 29, 1965, to enable him to visit a number of South American central banks following completion of his assignment at the Central Bank of Chile.

Letter to the Federal Reserve Bank of Philadelphia (copy attached as Item No. 4) regarding arrangements for the assignment to the Board's Division of Examinations of Frederick M. Manning, an assistant examiner for the Bank, for a period of approximately three months beginning May 24, 1965.

Letter to the Federal Reserve Bank of San Francisco (copy attached as Item No. 5) approving the reappointment of Robert J. Vilchinsky as examiner.

Memorandum from Mr. Young, Adviser to the Board, recommending the transfer of Nyart S. Sharigan from the position of Secretary in the Division of International Finance to the position of Secretary in the Board Members' Offices, with an increase in basic annual salary from $7,250 to $7,730, effective May 24, 1965.

Secretary

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 1
5/19/65

OFFICE OF THE CHAIRMAN

May 20, 1965.

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

Dear Mr. Chairman:

This is in response to your letter of April 1, 1965, asking for an updating of our previous comments with regard to float, particularly in the light of increased uses of automatic data processing equipment in check clearings. You also asked for information with respect to (a) the relationship between float and possible changes in reserve requirements of member banks, (b) the relationship between float and the Federal funds market, and (c) possible benefits to be derived if reserve computation periods were put on a monthly basis.

Developments during the past year include the following:

(1) The total number of checks handled by the Reserve Banks in 1964 was about 6 per cent higher than in 1963.

(2) Checks handled on automatic equipment increased from about 23 per cent of the total in 1963 to 53 per cent of the total in 1964.

(3) The daily average amount of total float during 1964 was about 8 per cent higher than in 1963, due mainly to the increase in the volume of checks handled.

(4) A special study showed that the amount of daily average float due to holdover in April 1965 was $227 million as compared with the $488 million disclosed by a similar study for April 1963. This reduction is largely the result of the increased use of automatic equipment.

	1963	1964	Per cent increase in 1964
Checks handled by Reserve Banks:			
Total number (in millions)	4,069	4,319	6.1
Per cent handled on automatic equipment	22.8	53.0	132.5
Daily average float (in millions):			
Total during year	$1,744	$1,885	8.1
Amount due to "holdovers" during month of April	$ 488	$ 227[1/]	-53.5

[1/] This figure is for April 1965. A special survey was made for that month comparable to one made for April 1963. No such survey was made in 1964.

In our letter of March 13, 1964, we indicated that a change in the deferment schedule--i.e., an increase, say, to three days--would reduce the volume of float. In the same letter the belief was expressed that, when the Reserve Banks are able to process most of their checks on highspeed equipment, it should be possible to change the deferment schedule without requiring member banks to make an additional sort. We also indicated in that letter that holdover float will be reduced as more and more commercial banks are able to deposit with the Reserve Banks checks that are fully coded for highspeed handling.

As indicated by the above table and summary comments, a substantial reduction has been made in holdover float. The Reserve Banks are still in a transition period with respect to the use of highspeed check handling equipment, however, and last year they processed only a little more than half of their checks in this manner. Not enough progress has yet been made in this undertaking to permit addressing the possibilities of the highspeed equipment toward changes in the deferment schedule or other means of reducing total float.

You also ask about the relationship between float and changes in reserve requirements of member banks. Whenever the Board considers an action to change reserve requirements, it necessarily takes into account the amount of reserves actually held by member banks, including the amount provided by float. The relationship between the total of required reserves of member banks and the reserves they actually hold is, of course, of special significance. If the average level of float were reduced substantially with a consequent substantial reduction in the level of actual reserves, and if no changes in monetary policy were desired, reserve requirements could be lowered correspondingly.

While the relationship between float and the Federal funds market is somewhat indirect, there has been a tendency for both the amount of float and the volume of Federal funds transactions to increase during the middle part of each calendar month. As a reason for this, it may be noted that when there is a rise in float and hence an increase in bank reserves, that increase tends to lead to offsetting open market sales of securities by the Federal Reserve System. To a large extent the payments for these securities are debited to the reserve balances of money market banks, in New York City and other principal centers. These transactions may lead, in turn, to purchases of Federal funds by these banks from other banks whose reserve balances are temporarily higher than they would have been if there had been no increase in float.

If a bank were to sell Federal funds beyond its excess reserves, it would then have a deficiency in its reserve account. If the deficiency persisted through the bank's reserve period, the bank would either have to borrow from its Reserve Bank, with its attendant disciplines, or it would be liable to penalties. The threat of such disciplines and penalties serves as an automatic governor, we believe, against excessive sales in the Federal funds market.

The question of the appropriate settlement period for Federal Reserve member banks is currently under active study by a Federal Reserve System committee. The proposal mentioned in your letter, to lengthen the settlement period to a month, is but one of several that have been advanced recently with the idea of improving the functioning of the reserve mechanism. Other proposals include equalizing the length of the settlement period for reserve city and country members at either one or two weeks, using the previous period's deposits instead of the current period's deposits as the basis for calculating reserve requirements, and staggering the settlement dates for groups of banks to avoid the wide swings in money market pressures sometimes occasioned by a common settlement date for all member banks.

With respect to the particular proposal that was mentioned in your letter, various of the factors both for and against it are set forth in a series of four articles that were published in the Journal of Finance for March and September 1964, authored by a leading banker, a staff member of the American Bankers Association, and an official of the Federal Reserve Bank of New York. If you wish, we would be glad to provide your staff with copies of these materials. Our own research work on these proposals has not, however, proceeded far enough for the Board to take a definite position on the advisability of changing the existing structure of member bank settlement periods at this time.

Sincerely yours,

Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
5/19/65

OFFICE OF THE CHAIRMAN

May 21, 1965

The Honorable Wright Patman,
Chairman,
Banking and Currency Committee,
House of Representatives,
Washington, D. C.

Dear Mr. Chairman:

Enclosed are tables containing officers compensation data from reports of examination developed pursuant to the specifications of Professor Jacobs as part of the 1963 Management Succession Study. All other requested tabulations related to this study were completed and delivered to Professor Jacobs last summer.

Many of the enclosed tables show salary information pertaining to individual banks and one entire series of tables for the New York consolidated area contains such detailed information that their publication might disclose compensation for an individual or information pertaining to an individual bank. However, all compensation tables that were developed are enclosed for their analytical value with the understanding that (1) tables for the New York area will not be published, and (2) in all other tables when less than three banks are shown in a cell, an asterisk will be substituted prior to their publication with the explanation that the asterisk represents less than three banks.

Professor Jacobs has agreed that the publication of the New York tables is not essential to the successful completion of his study.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 3
5/19/65

OFFICE OF THE VICE CHAIRMAN

May 24, 1965

The Honorable Wright Patman, Chairman,
Banking and Currency Committee,
House of Representatives,
Washington, D. C. 20510

Dear Mr. Chairman:

At the hearing before your Committee of April 26, 1965, with respect to H. R. 7539, Representative Reuss requested the staff of the Board of Governors to prepare a draft amendment designed:

(1) to prohibit a bank from purchasing, for any of its trust accounts, securities that it is underwriting;

(2) to prohibit a bank from selling such securities to its borrowers or correspondent banks; and

(3) to require all sales of such securities to be preceded by disclosure of the bank's position as underwriter.

A draft of amendment along these lines is enclosed. A similar draft was furnished Mr. Reuss prior to the decision of the Committee to table consideration of H. R. 7539 on April 27, 1965.

Mr. Reuss also requested that I submit comments on the draft amendment for inclusion in the record. Those comments are enclosed.

Sincerely yours,
(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

Enclosures

Draft amendment to H. R. 7539 prepared by the Staff of the Board of Governors of the Federal Reserve System based upon a request of Representative Reuss of April 26, 1965

On page 3, line 8, strike out beginning with "the" and continuing through the period in line 11, inserting in lieu thereof the following: "no association that is engaged in underwriting such obligations (including general obligations of a State or a political subdivision thereof) shall (a) purchase any of such obligations for any account with respect to which the bank acts in a fiduciary capacity, or (b) sell any of such obligations to any borrower or to any bank with which it has a correspondent relationship, or (c) give investment advice as to any of such obligations to any person without first disclosing directly to such person, in writing, the extent and nature of its underwriting interest with respect to such obligations, and (3) no association that is engaged in dealing in such obligations (including general obligations of a State or a political subdivision thereof) shall purchase any of such obligations from itself for any account with respect to which the bank acts in a fiduciary capacity."

COMMENTS OF C. CANBY BALDERSTON, VICE CHAIRMAN,
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
ON PROPOSED AMENDMENT OF
REPRESENATIVE REUSS TO H. R. 7539, 89TH CONGRESS

This memorandum analyzes a proposed amendment to H. R. 7539 to avoid certain conflicts of interests that could arise when banks engage in the business of underwriting and dealing in securities. The amendment was prepared by the staff of the Board of Governors at the request of Representative Reuss.

(1) Self-dealing. A bank would be prohibited from purchasing any obligation that it is underwriting for any account with respect to which the bank acts in a fiduciary capacity. It would also be prohibited from purchasing from itself, for any such account, any obligation that it deals in. A bank would not, however, be prohibited from purchasing for its own account obligations that it underwrites or deals in - that is, a bank could transfer such securities from its bond trading account to its investment securities account.

Consequently, the conflict between the bank's interest as seller and its interest as purchaser would continue to exist in an important area, insofar as potential loss to stockholders is concerned. A loss in a trust account would affect the interests of stockholders or depositors only if a surcharge were imposed by a court for a failure by the bank as trustee to act properly in connection with the cause of the loss. A loss arising from securities held by the bank for its own account would, however, affect adversely the interests of its depositors and stockholders.

To eliminate entirely the conflict of interests that is involved in self-dealing would require a prohibition against a bank purchasing, either for its fiduciary accounts or for its own account, any obligation that it underwrites or deals in. To do this, however, would mean that a bank and its trust accounts would be deprived of the opportunity to invest in securities that objective analysis might indicate were desirable investments.

A prohibition against purchases only during the underwriting period (such as, in the draft amendment, by a bank as fiduciary) would neither eliminate all conflicts of interests nor afford the bank as trustee or investor, as the case may be, the opportunity to act in all cases for the best interests of its trust beneficiaries, depositors, and stockholders. The best interests of an investment portfolio depend not only upon the securities selected but also upon the timing of purchases and sales. Frequently, a security can be purchased during the underwriting period at a lower price than is available later.

(2) Sales to borrowers and correspondents. The draft amendment would prohibit a bank from selling any obligation that it is underwriting to (a) any person who is indebted to the bank or (b) any bank with which it has a correspondent relationship. Sales to such persons after the period of distribution would not be prohibited. Nor would the bank be prohibited from advising the borrower or correspondent to purchase the security from another member of the underwriting syndicate. As sales from another member of the syndicate would have a

definite, although indirect, beneficial effect on the position of the bank as underwriter, whether this limited prohibition would be effective is questionable.

A prohibition against sales to borrowers and correspondents of securities the bank deals in might be more effective with respect to the conflict of interests that arise in connection with a bank giving investment advice after the underwriting period. Such a prohibition might be circumvented through reciprocal arrangements between dealer banks. Apart from this possibility, however, the potential conflicts would be less serious than in the case of underwriting. Sales by another member of the underwriting syndicate promote the interests of a bank much more definitely than sales by another dealer in a security. When a bank participates in an underwriting, in many cases it is involved in a joint venture under which sales by one member benefit all the others as well. When dealing in a security, on the other hand, a bank generally acts alone and can profit significantly only from its own sales. To the extent that such a prohibition proved effective, the result could be that banks would determine that it was no longer worthwhile to deal in securities.

As correspondent banks constitute a major source of sales for metropolitan banks' bond departments, a prohibition solely against such sales of a security the bank is underwriting or dealing in might itself be sufficient reason for some banks to consider withdrawing from the securities business.

(3) Sales to others. The proposed amendment would require that prior to any sale of a security that the bank is underwriting the customer must be informed of the extent of the bank's underwriting interest. Whether such a notice would be effective is doubtful. Conceivably, an investor might be more favorably inclined to purchase a security with respect to which such notice had been given than if he had not received such notice. He might reason that, if the bank has an interest in the security, it must have reached a favorable conclusion as to the security's worth as an investment. In other words, many persons might overlook the distinction between bank underwriting and bank investing, and to prescribe specific wording that would effectively convey this point probably would not be practicable.*

Conclusion. The draft amendment would prevent only to a limited extent conflicts of interests that necessarily arise when a bank underwrites and deals in securities and continues to perform its other functions. Prohibitions that would remove all or even the more significant conflicts of interests might, however, result in banks eliminating their bond departments, or reducing their operations, despite other features of H. R. 7539 that would enlarge the permissible scope of such operations.

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* Perhaps a more effective approach would be to require the bank to set forth both the extent of its underwriting interest and its investment interest in the security. A person who purchased a security after he had been informed that the bank had a certain underwriting or dealer interest in a security but no investment interest might be better protected against being misled than a person who was only informed as to the bank's underwriting position.

Even if the elimination of conflicts of interests would not deter a bank from underwriting and dealing in securities, their elimination may be harmful, particularly to the interests of the bank's fiduciary accounts, depositors, and stockholders. The elimination of the conflict between the bank's interest as seller and its interests as purchaser in itself conflicts with the interests of the bank as purchaser for its own or its fiduciary accounts.

Therefore, the avoidance of such conflicts could be achieved only by preventing banks from performing with maximum effectiveness some of their most beneficial functions. Two of these functions, banks' activities as fiduciaries and as correspondent banks, are and can be performed in no other way. The question consequently arises whether the benefits of expanding banks' underwriting powers outweigh the detrimental effects of barring them from the best performance of certain important banking functions.

This significant point may be stated in another manner. Banks now serve the public and the economy in a variety of ways, including service as fiduciary, correspondent bank, and investment adviser. Banks could also perform a service as underwriters of revenue bonds. Participation of banks in <u>all</u> of these activities would give rise to conflicts of interests that should be avoided. Heretofore such conflicts have been prevented, to a considerable extent, by barring banks from the investment banking field except with respect to "general obligations".

The draft amendment is designed to make acceptable bank entry into this field by "preventing conflicts of interests". But such conflicts would be prevented - and could be prevented - only by hampering banks in their performance of even more valuable functions, which now constitute an important part of banks' regular activities. In the nature of the situation, there seems to be no other feasible method to "prevent" the threatening conflicts.

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

Item No. 4
5/19/65

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

May 19, 1965.

Mr. Karl R. Bopp,
President,
Federal Reserve Bank of Philadelphia,
Philadelphia, Pennsylvania 19101.

Dear Mr. Bopp:

In accordance with the tentative arrangements made with Chief Examining Officer Giacobello by the Board's Division of Examinations, it is understood that your Bank will make available, for a period of approximately three months, beginning May 24, 1965, the services of Mr. Frederick M. Manning, an Assistant Examiner for your Bank. While in Washington Mr. Manning will be assigned to the foreign banking section of the Board's Division of Examinations, but it is also hoped he will have an opportunity to become generally familiar with the work of the Division as a whole and to visit other divisions of the Board. While on assignment in Washington, Mr. Manning will be designated as a Federal Reserve Examiner.

It is understood that the Federal Reserve Bank of Philadelphia will absorb all of Mr. Manning's salary and travel expenses in connection with the assignment.

The Board of Governors appreciates the cooperation of your Bank in making the services of Mr. Manning available during this period.

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. 5
5/19/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 19, 1965

Mr. E. H. Galvin, Vice President,
Federal Reserve Bank of San Francisco,
San Francisco, California. 94120

Dear Mr. Galvin:

In accordance with the request contained in Mr. Cavan's letter of May 14, 1965, the Board approves the reappointment of Robert J. Vilchinsky as an examiner for the Federal Reserve Bank of San Francisco, effective June 1, 1965.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.