

Minutes for September 13, 1965

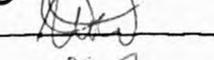
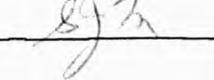
To: Members of the Board

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	<u></u>
Gov. Robertson	<u></u>
Gov. Balderston	<u></u>
Gov. Shepardson	<u></u>
Gov. Mitchell	<u></u>
Gov. Daane	<u></u>
Gov. Maisel	<u></u>

Minutes of the Board of Governors of the Federal Reserve System on Monday, September 13, 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

Miss Carmichael, Assistant Secretary
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Sammons, Adviser, Division of International Finance
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mrs. Semia, Technical Assistant, Office of the Secretary
Messrs. Forrestal, Sanders, and Young, Senior Attorneys, Legal Division

Fiscal agency agreement (Item No. 1). There had been circulated a draft of letter to the Federal Reserve Bank of New York that would approve (1) the Reserve Bank's acting as fiscal agent with respect to the proposed issue by the International Bank for Reconstruction and Development of its Two Year Bonds of 1965, due September 15, 1967, and (2) the execution and delivery by the Reserve Bank of an agreement with the International Bank for this purpose.

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The letter was approved unanimously. A copy is attached as Item No. 1.

Messrs. Sammons and Young then withdrew from the meeting.

Payment of excessive interest on deposits (Item No. 2). After consideration at several meetings of legislative proposals formulated by the Federal Deposit Insurance Corporation to cope with problems relating to methods through which some banks had sought to attract deposits, the Board in a letter of June 23, 1965, informed the Bureau of the Budget that it favored the enactment of legislation that would accomplish the objectives of a draft bill that had been presented by the Corporation, although there were problems of draftsmanship that needed attention. The Board's staff had worked with the staff of the Corporation in preparing the draft bill that the Corporation had submitted to the Bureau of the Budget, and continuing interagency staff conferences resulted in a revised draft bill that was further revised after a discussion by the Board on July 1, 1965, with Chairman Randall and members of the staff of the Corporation.

There had now been distributed a memorandum dated September 8, 1965, from the Legal Division regarding a request from the Chairman of the Senate Committee on Banking and Currency for the Board's views on S. 2354, introduced at the request of the Federal Deposit Insurance Corporation, "To amend the Federal Deposit Insurance Act and the Federal Reserve Act with respect to the payment of deposits and interest thereon,

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to limit the payment of compensation for obtaining deposits, and for other purposes." The principal purposes of the bill were (1) to prevent or regulate certain practices that apparently had resulted or might result in violations of Federal laws and regulations governing payment of interest on deposits and (2) to authorize the Corporation and the Board to impose penalties for violations of provisions of the bill or the present rules with respect to payment of deposits or interest thereon. The bill would authorize "a penalty of not more than 10 per centum of the amount of the deposit to which such violation relates." Such a provision should be simple to understand and to apply, and the need for a more effective penalty for violation of the Board's Regulation Q, Payment of Interest on Deposits, was unquestionable, but it might be debatable whether a penalty would have to be as high as 10 per cent of the amount of the deposit in order to be effective. That percentage would be the maximum, however, and the Board would be free to impose lesser penalties, either by general regulation or on an individual case basis.

The memorandum pointed out that the bill provided that no "bank or officer, director, agent, or substantial stockholder thereof shall pay or agree to pay a broker, finder, or other person compensation for obtaining a deposit for such bank." Exemptions from the prohibition could be made by regulation of the Board or of the Federal Deposit Insurance Corporation, depending upon whether or not the bank involved

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was a member of the Federal Reserve System. The Legal Division expressed the view that there was some question whether some of the transactions that would be prohibited, directly or indirectly, should be prevented, either in whole or in part. Specific examples of transactions that might be unlawful in the absence of exemptions were cited and discussed.

The memorandum concluded with the Legal Division's recommendation that the Board favor enactment of S. 2354; a draft of report in those terms to Chairman Robertson of the Senate Committee on Banking and Currency was attached. The proposed letter was accompanied by several minor drafting suggestions concerning the bill which, for reasons mentioned in the memorandum, it was suggested be submitted directly to the Committee as a part of the Board's report.

During introductory comments Mr. Sanders suggested changes in the draft letter based on comments that had been made to him by Governor Shepardson, and there was concurrence by the other members of the Board with these changes as well as with a change suggested by Governor Robertson in the attachment to the letter.

The ensuing general discussion turned principally on the relative merits of specifying some exempted transactions in the proposed legislation or leaving the details of exemptions to be worked out by the regulatory agencies. The possibility was suggested that differing regulations as to exemptions might be adopted by the Board and by the Federal

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Deposit Insurance Corporation. Responses indicated that interagency staff discussions had included consideration of specifying some exemptions in the proposed law, but it had been deemed preferable to leave the discretion with the administering agencies. Also, the staffs of the Board and of the Corporation had been working closely together on the probable terms of regulations, and there appeared reasonable assurance that basically uniform regulations could be achieved.

The letter and its enclosure, with the changes that had been suggested, were then approved unanimously in the form attached as Item No. 2.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the recommendation contained in memoranda from the Division of International Finance dated March 18 and September 1, 1965, that a new position of Statistical Assistant be established in the Europe and British Commonwealth Section of that Division.

Elizabeth L. Carmichael
Assistant Secretary

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

Item No. 1
9/13/65



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 13, 1965

Mr. Marcus A. Harris, Vice President,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Harris:

This refers to your letter of September 2, 1965, and enclosures, concerning the proposed issue by the International Bank for Reconstruction and Development of \$100 million aggregate principal amount of its Two Year Bonds of 1965, due September 15, 1967. In your letter you state that it is proposed to amend Schedule A of the Fiscal Agency Agreement, dated as of February 6, 1950, between International Bank and your Bank to include the bonds in question.

The Board of Governors approves your Bank acting as Fiscal Agent in respect of the proposed issue by the International Bank of its Two Year Bonds of 1965, due September 15, 1967, and approves the execution and delivery by your Bank of an Agreement with the International Bank substantially in the form of the draft of Supplement No. 26 to the Fiscal Agency Agreement, dated as February 6, 1950, between your Bank and the International Bank, enclosed with your letter.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
9/13/65

OFFICE OF THE CHAIRMAN

September 14, 1965

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

Dear Mr. Chairman:

This is in response to your request for the views of the Board of Governors on S. 2354, a bill "To amend the Federal Deposit Insurance Act and the Federal Reserve Act with respect to the payment of deposits and interest thereon, to limit the payment of compensation for obtaining deposits, and for other purposes."

The Board believes that the provisions of section 19 of the Federal Reserve Act and the Board's Regulation Q relating to the payment of deposits and interest thereon would be more effective if the Board were able to impose a suitable penalty for violations thereof. As you know, the present sanctions for violations of those provisions are termination of Federal Reserve membership and removal of offending officers or directors of the member bank - both of which are too severe to be used in many cases.

S. 2354 would authorize "a penalty of not more than 10 per centum of the amount of the deposit to which such violation relates." Such a provision should be an effective deterrent, simple to understand and to apply. The percentage authorized would be the maximum, and the Board would be free to prescribe lesser penalties, either by general regulations or on an individual case basis.

Those provisions of the bill that relate to the payment of compensation for obtaining deposits are directed toward the prevention or regulation of certain practices that apparently have resulted or might hereafter result in violations of federal laws or regulations governing payment of interest on deposits. To the extent that the Board might determine that such transactions do not contribute to receipt by a depositor of interest in excess of the maximum permissible rate and are not otherwise objectionable, it could permit them by regulatory exemption.

Enclosed for the Committee's consideration is a memorandum containing minor drafting suggestions (1) to tie together the prohibition and penalty provisions and (2) to eliminate repetitious language that would appear in the Federal Reserve Act if the bill were enacted in its present form. The Board favors enactment of the bill with amendments to incorporate those suggestions.

Very truly yours,

(Signed) Wm. McC. Martin, Jr.

Enclosure

Wm. McC. Martin, Jr.

a. A minor defect in the bill is that the prohibition and penalty provisions do not fit together. Payment of compensation for obtaining a deposit is declared unlawful whether made by a bank, or by an "officer, director, agent, or substantial shareholder thereof"; however, only a bank would be subject to penalty.

Because the bill draws a distinction between a bank and an "officer, director, agent, or substantial shareholder", a court might interpret the bill in such a manner that only payments formally approved by a bank's board of directors or stockholders would be attributed to the bank. In such an event, an unlawful payment by the bank's officer, unauthorized by such formal corporate action, would not subject anyone to a penalty, irrespective of the source of funds for the payment. On the other hand, payment by a third person who has no relationship with the bank, made to induce another person to make a deposit in the bank, would subject the bank to a penalty if it accepted the deposit with knowledge of such payment. Such results are incongruous: a transaction over which a bank might be expected to have considerable, if not full, control could not be penalized, although a transaction over which a bank might have no control would subject the bank to a penalty.

Even if the bill were interpreted to impute to a bank payment by its officer from bank funds, the result would not be entirely satisfactory. A payment by the officer out of his own funds to a broker or any other person for obtaining a deposit still would not subject anyone to a penalty.

These results could be avoided by imputing to the bank all payments by an "officer, director, agent, or substantial stockholder thereof". This might be accomplished by the following:

(1) On page 1, amend the sentence beginning at line 9 to read as follows: "(2) no insured nonmember bank, including an officer, director, agent, or substantial stockholder thereof, shall pay or agree to pay a broker, finder, or other person compensation for obtaining a deposit for such bank, except as the Board of Directors may permit by regulation or order."

(2) On page 3, amend the sentence beginning at line 9 to read as follows: "No member bank, including an officer, director, agent, or substantial stockholder thereof, shall pay or agree to pay a broker, finder, or other person compensation for obtaining a deposit for such bank, except as the Board of Governors of the Federal Reserve System may permit by regulation or order."

b. The last paragraph of section 2 of the bill duplicates provisions of the first paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 461). Under both, the Board could "prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section [19] and prevent evasions thereof" and determine "what shall be deemed to be a payment of interest".

The repetitious grant of such authority could be eliminated by amending the bill as follows:

(1) On page 4, beginning with line 16 strike out "and to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof".

(2) Redesignate the present section 3 as section 4.

(3) Insert a new section 3 as follows:

"SEC 3. The first paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 461) is amended by striking out ', to determine what shall be deemed to be a payment of interest,'."

Board of Governors of the Federal Reserve System
September 13, 1965.