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 Tuesday, September 14, 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. Kenyon, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Molony, Assistant to the Board
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. Johnson, Director, Division of Personnel Administration
Mr. Harris, Coordinator of Defense Planning
Mr. Hexter, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Holland, Associate Director, Division of Research and Statistics
Mr. Koch, Associate Director, Division of Research and Statistics
Mr. Partee, Adviser, Division of Research and Statistics
Mr. Solomon, Adviser, Division of Research and Statistics
Mr. Dembitz, Associate Adviser, Division of Research and Statistics
Mr. Daniels, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Sprecher, Assistant Director, Division of Personnel Administration
Mrs. Semia, Technical Assistant, Office of the Secretary
Discount rates. The establishment without change by the Federal Reserve Bank of Boston on September 13, 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.

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

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<td>Letters to Wells Fargo Bank, San Francisco, California, approving extensions of time to establish branches in Richmond, Monterey, and Mountain View.</td>
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<td>Letter to the Joint Committee on Defense Production transmitting an annual report on mobilization activities.</td>
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<td>5</td>
<td>Letter to the Federal Reserve Bank of San Francisco regarding a request for confidential treatment of certain information in the application of United California Bank, Los Angeles, California, to merge with The Feather River National Bank, Oroville, California. (The letter as approved reflected a change suggested by Governor Robertson during discussion.)</td>
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Report on competitive factors (Los Angeles, California). A report to the Comptroller of the Currency on the competitive factors
involved in the proposed merger of Wilshire National Bank into Heritage National Bank, both of Los Angeles, California, was approved unanimously for transmittal to the Comptroller. The conclusion read as follows:

The proposed merger of Wilshire National Bank into Heritage National Bank would not have adverse competitive effects.

Messrs. Harris and Egertson then withdrew from the meeting.

Promissory notes of member banks. In September 1964, First National Bank of Boston, Boston, Massachusetts, announced its intention to issue its own unsecured notes in multiples of $1 million, with maturities tailored to a broad range of customer requirements. The Comptroller of the Currency issued a ruling that the sale of such notes was legal for national banks. In response to inquiries regarding this practice, the Board stated in a press release of September 9, 1964, that "Since they constitute borrowings, such notes are not subject, under present law and regulations, to the interest rate limitations or reserve requirements prescribed for deposits by the Board of Governors." The release further stated that "The legality of the issuance of notes of the type referred to must be determined in the light of applicable Federal and State laws, and it is assumed that any bank borrowing by means of such notes will satisfy itself that their issuance is authorized."

In letters of October 20, 1964, pursuant to action by the Board on October 15 in connection with a proposed revision of Regulation Q, Payment of Interest on Deposits, the Federal Reserve Banks and the Federal
Deposit Insurance Corporation were asked for their views as to the advisability of amendments (such as had been suggested by Governor Robertson) to Regulation Q and to Regulation D, Reserves of Member Banks, that would define deposits to include funds obtained through the use of short-term notes. The Corporation did not reply; the views of the Reserve Banks had a predominantly doubtful or negative leaning.

Draft legislation formulated by the Federal Deposit Insurance Corporation during the early months of 1965 in an effort to cope with methods being used by some banks to attract deposits included a provision that would make the payment of interest by banks on short-term notes subject to the rules governing interest on deposits. However, during a discussion by the Board with Chairman Randall and members of the staff of the Corporation, it was brought out that staff officers of the American Bankers Association had informally expressed reservations as to that provision, and there was agreement with a suggestion by Governor Robertson that the provision be deleted from the draft legislation, leaving the matter to be covered by interpretation.

After the announcement by First National of Boston, various other banks also began to issue short-term notes. These did not include any of the banks in New York, because State law prohibited banks from issuing "any bank bill or note unless it is payable on demand without interest." Recently, however, Morgan Guaranty Trust Company of New York proposed to issue short-term, non-negotiable promissory notes under a
plan that counsel for the bank believed would not violate State law. Late in August 1965 the State Superintendent of Banks concurred with that view, stating in part that "For the purposes of reserve requirements and interest limitations, the Department will consider any such advance of money to be a borrowing by the bank rather than a deposit."

There had now been distributed a memorandum dated September 2, 1965, from Governor Robertson attaching a draft of amendment to Regulation Q (a corresponding amendment to Regulation D being assumed) that would define the term "deposit" as "any indebtedness of a member bank that arises out of a transaction in the ordinary course of its business with respect to either funds received or credit extended by the bank, except (1) indebtedness due to a Federal Reserve Bank, (2) indebtedness due to another bank for its own account that is not reflected on the books or reports of the debtor or of the creditor as a deposit or as a cash balance, and (3) indebtedness subordinated to the claims of depositors and general creditors." Attached to the memorandum were an explanation of the draft amendment and a memorandum on the legal bases, with reasons why the language of the present proposal differed from some previous suggestions on this subject.

Governor Robertson proposed that the Board promptly publish such amendments in the Federal Register for comment. He suggested that the appropriate form of interagency cooperation would be (1) to inform the Comptroller of the Currency and the Federal Deposit Insurance Corporation of the notice of proposed rule making at the time it was dispatched
to the Federal Register, and (2) to furnish to the Corporation at the same time copies of the proposal and the explanation for its use in the event the Corporation might wish to publish a similar proposed amendment to its regulation corresponding to Regulation Q.

Governor Robertson's proposal had been discussed in a preliminary way at the Board meeting on September 9, 1965. In view of various questions asked and requests made at that time, there were subsequently distributed to the Board a number of pertinent papers, including material such as subcommittee reports, interpretations, and minute excerpts.

At the beginning of today's discussion Chairman Martin requested comments from the Legal Division as to the Board's authority to prescribe a definition of the term "deposit" such as Governor Robertson proposed.

In response, Mr. Hackley stated that the legal staff was convinced that the Board had authority in this respect. In addition to specific authority in the statute for the Board to define certain terms, including the terms "time deposits" and "demand deposits" for purposes of section 19 of the Federal Reserve Act, he believed that the Board's responsibility for carrying out the intent of, and administering, the law necessitated that the Board in certain cases determine whether a particular type of obligation gave rise to a deposit liability. As a matter of fact, the Board had done so in many published rulings with respect to reserve requirements from the earliest days of the System. His own view was that as a legal matter the Board clearly had authority
to define by regulation what constituted a deposit for purposes of Regulations Q and D, and that it also could do so through interpretation.

In response to an inquiry by Governor Daane there ensued a discussion of the relevance, as a legal matter, of subordination of the notes to deposits. It was brought out that although at least one State required subordination, the notes generally were not subordinated; those of First National of Boston were on a parity with deposits. Mr. Hackley expressed the view that the point of subordination was not necessarily conclusive. For example, he felt that the Board could by definition legally exclude from deposit liabilities instruments that were subordinated to the claims of depositors and other creditors.

Governor Robertson commented that he believed the Board could legally define even subordinated notes as deposits. However, the draft amendment he had offered had not done so because there did not seem to be a need to go that far.

In response to a question by Governor Daane as to whether the Board could require that the notes be subordinated, Mr. Hackley indicated that the terms of issuance of the notes were a matter of contract between a bank and its customer.

Chairman Martin inquired as to the basis for the doubts that had been expressed by the Reserve Banks in response to the request for their views as to the advisability of defining deposits so as to include promissory notes.
Mr. Hackley replied that only one Reserve Bank had actually favored such a definition, the others taking exception to it in differing degrees, not so much on legal as on policy grounds. There had been a feeling that such a definition would be contrary to the traditional concept of deposits. Some of the Reserve Banks also were concerned that such a definition would be regarded by the public as a reversal of the position taken by the Board in September 1964.

Governor Shepardson remarked that the latter point was of concern to him. By saying that under existing law and regulations the notes were borrowings, the Board had appeared to put itself in a position where it could not rule otherwise in the absence of a change in the law as well as the regulations.

Mr. Hackley said he thought the intent of the statement was to say that the regulations could be amended if the Board found it desirable to treat the funds arising from the notes as deposits. Mr. Hexter added that in any event the Board had explicit statutory authority to prevent evasions of section 19. The Board's 1964 statement was of a permissive character, but it had since become apparent that the notes could be used as a means of circumvention, which pointed to the use by the Board of its clearly-stated regulatory power.

Chairman Martin then called for comments from the economists present, in response to which Mr. Brill stated that his views were somewhat mixed. As an economist, he felt that the proposed definition was
in a sense a retrogression from the position the Board had been taking in recent years toward permitting banks to compete more vigorously in financial markets -- a position most economists had applauded as improving the efficiency of financial markets and the structure of interest rates. From the supervisory point of view, however, there was a problem in that a statute was being evaded, and as long as a statute was on the books it should be enforced. His personal preference would be to continue to move in the direction of putting on a standby basis the authority to prescribe maximum rates of interest payable on deposits (a position that the Board had officially taken, most recently in a letter of August 9, 1965, to the Bureau of the Budget). He would hope that if the Board took the proposed action its public announcement would not suggest abandonment of support of a move in that direction.

Mr. Koch said he would prefer to wait and see what happened. He doubted that the practice would develop very far; and if it were just the big banks he did not believe there would be too much of a problem -- only if the little banks began to make unsound credit extensions. Basically, this was not a problem on which he felt an economist could be of a lot of help. The question of the effectiveness of monetary policy was not at stake. Aside from the legal factor, the problem involved principally the safety and soundness of the banking system. The development must be thought of as one part of the whole problem of the changing activities of the commercial banking system -- the banks' asset structure,
their sources of funds, and their ability to compete for funds. In a sense every element of the liability side of a bank's balance sheet was debt except capital. In his view it would be better to think of the problem as a whole rather than take precipitous action with respect to a minor element of it. He would prefer to approach the problem through study of the liquidity and risk factors associated with a given balance sheet structure. As to regulation through interest rates, he thought the Board had moved quite a bit down the line when it allowed banks to pay 4 per cent on less than 90-day deposits. If one were going the interest-rate route, he would suggest retreating to an interest rate structure based on maturity. But in the long run he hoped it would be possible to get away from price regulation, which would mean eventually facing up to the question of payment of interest on demand deposits.

Mr. Hackley commented that from the practical point of view it was necessary to recognize that, even though the Board had the statutory authority to take the proposed action, it was unlikely -- to judge from the record -- that such an amendment would be enforced with respect to national banks, with the result that State member banks would once again be placed at a competitive disadvantage.

Mr. Dembitz remarked that to the extent that banks could issue unsecured notes they were able to decide whether they would be subject to reserve requirements and to interest rate regulations, thus placing the Board in a rather untenable position. He believed that the banks
should be brought under control in this respect. At the same time the Board should make clear that its action was not a further move in the direction of regulation of interest rates, but instead represented a carrying out of the Board's statutory responsibility unless and until the law was changed.

Mr. Holland said that as an economist he shared generally the view of disliking to deal with this problem through quantitative restraint. However, there was a price control measure on the statute books. He did not think that if promissory notes were defined as time deposits this would impose an insuperable handicap on the banks. The banks, he noted, had some $16 billion of certificates of deposit outstanding. However, if the proposal were adopted, a problem would arise in the area of very short-term borrowing. Banks would not be able to incur any interest-bearing debt in that maturity range because all money obtained would be classified as demand deposits. But banks were now incurring a fair amount of short-term debt ranging in maturity from one to thirty days. This would suggest that at an early date consideration perhaps should be given to shortening the maturity of what was defined as a demand deposit to some period such as 10 or 15 days. This might be a way of blunting the impact on the money market of action such as was being proposed for the Board's consideration. It would allow some kind of debt with very short maturity to continue to exist.
Mr. Solomon (Research) commented that it was difficult to understand how the Board could sit by and permit the existence of a loophole in regulations that it presumably was attempting to enforce. One way for the Board to work its way out of this untenable position would be to get a change in the law that required the Board to prescribe maximum interest rates. If the Board did not wish to move further down the road of regulating interest rates on bank deposits, this would be a clean-cut solution. He observed that most of the discussion had revolved around Regulation Q implications and little around Regulation D implications. He was not at all sure that the same considerations applied to both aspects. There seemed to be near-unanimity among the economists in favoring a move away from the Regulation Q-type regulation, but he was not sure the same view would be held as to Regulation D.

Mr. Young stated that the problem of the issuance of notes as an evasive device was one that caused him concern. With all due respect for the case for allowing banks maximum freedom to compete, he recalled clearly the troubles that had culminated in the debacle of the 1930's, partly as a result of excessive competition in which banks committed themselves to fixed charges that they were unable to reduce sufficiently when the circumstances of the economy changed abruptly. It seemed to him that long-range credit and supervisory policy should be addressed to maintaining a banking system as a healthy, going concern, so that when situations developed in which the public sought liquidity in forms
other than bank deposits, banks were able to make the necessary adjustments. In the framework of this long view, there was much to be said for Regulation Q if it could be reasonably administered. It followed that there was also much to be said for taking prophylactic action to reduce the risks of too much competitive freedom.

Governor Maisel said he would accept the position that the Board had the legal right to make the proposed definition, but he did not regard that as the key point. Instead, it was the policy question as to whether such action was warranted, given the Board's responsibilities in the fields of monetary policy and bank supervision. The Board had stated that it would regard funds obtained through notes as borrowings at the present time, and for various reasons he would favor letting that statement stand. However, it would be well to strive for an over-all, unified supervisory policy with respect to the total debt structure of banks, bringing in not only notes but also Federal funds transactions, lease-backs, and other types of debt. It seemed to him that the essential problem was to appraise the debt structure of a bank in relation to its capital and surplus. Therefore, although the Board could take the position that it had the right to define notes as deposits if necessary, he believed that for the time being the approach of regarding the notes as only one part of the total problem and working toward uniform instructions and theory by bank supervisors to deal with the entire debt structure of banks would place the Board on much stronger ground.
Chairman Martin commented that the practical aspects of the matter mentioned by Mr. Hackley had an important bearing. Since there seemed no question but that the Comptroller of the Currency would reject the proposed definition, he questioned whether, even if the Board believed that definition to be correct, there was much to be gained by taking a position that could be disregarded by all national banks.

Mr. Hackley remarked that it also seemed unlikely that the Federal Deposit Insurance Corporation would adopt a similar amendment. There was a vacancy at present in the directorate of the Corporation, and one of the two directors in office was the Comptroller of the Currency.

Mr. Hexter observed that the situation with respect to Regulation D was somewhat different. If a member national bank failed to maintain its reserves at the required level, the Federal Reserve could take action that would establish the bank's obligation.

Governor Balderston remarked that Congress had given the Board responsibility for enforcing a statute that prohibited the payment of interest on demand deposits. Although adoption of that law was an invasion of the free market philosophy, the motives of Congress were understandable, experiences of an earlier period having persuaded it that banks should not be tempted into imprudence in bidding for demand deposits and that the ability of large New York City banks to suck funds from the hinterlands should be inhibited. Of the two motives, he was
more concerned about the first. Under present circumstances, if the
distinction between time deposits, on which interest was permitted to
be paid, and demand deposits, on which Congress had said that interest
must not be paid, was being blurred, what was the Board's responsibility?
Could it ignore the fact that bankers had invented a way to pay interest
on deposits that were little if any different from demand deposits when
the Congress had said that interest must not be paid on demand deposits?
Like the economists, he subscribed to the free market philosophy and
disliked price-fixing invasions of that freedom. However, after watch-
ing the growth of the use of negotiable certificates of deposit, he could
believe that a considerable number of aggressive banks would go after
business through issuing unsubordinated notes of maturities even as short
as a couple of days. Therefore, the Board was faced with a dilemma. The
question was whether, if existing law was being evaded through banker
ingenuity, the Board was obliged to act; and, if it did not act, whether
the banking structure would be injured or weakened by the forces of
competition that underlay the inventiveness of the bankers. He could
agree with the approach of the economists when it came to longer-term
borrowing. However, he was bothered by the blurring of the boundary
between demand deposits and near-demand deposits.

Mr. Brill replied that the dilemma outlined by Governor Balderston
involved a deep problem, partly philosophic and partly practical, as to
how one felt that the banking system could operate most efficiently. Aside
from the principle of free markets, an effort to control banking policy through interest rate regulation might not be the most effective supervisory policy. Even with rate ceilings in effect, banks could get into trouble by the use of certificates of deposit. In his view, the whole area ought to be re-examined; although there was a great deal of material on the subject, much of it was of inferior quality. He was not convinced that the present structure was adequately meeting current needs from either the standpoint of monetary policy or that of bank supervision. On the other hand, an existing law had to be enforced, and on that ground he had felt the present proposal might be about the only thing that could be done for the purpose at the moment, as long as its announcement did not suggest a move toward the concept of further price regulation.

Governor Balderston asked if it was feasible, assuming that the cooperation of the Comptroller's examining staff could be obtained, to diminish the emphasis on capital cushions and increase the emphasis on liquidity. Could it be expected that with such a shift of emphasis bank examiners could reasonably assure a sound banking structure over the next decade?

Mr. Solomon (Examinations) commented that the problem was not a simple one. Cogent arguments could be offered from several different viewpoints -- economic, supervisory, legal, and practical. From the economic viewpoint, there were obvious advantages in free markets and against any interference with them in the absence of compelling reasons.
Because of grievous experience, however, Congress had been persuaded that it was necessary to interfere with free markets in terms of the payment of interest on deposits. Mr. Solomon did not have any doubt that the issuance of short-term notes by banks was an effort to evade Regulation Q, and to a lesser extent Regulation D. From the practical point of view, however, he had serious question as to what was to be accomplished by the proposed amendment, regardless of how great a need it was intended to serve, since there did not seem to be any effective means of enforcing it as far as national banks were concerned, and national banks held about half of the assets of the banking system.

The Board had a little more enforcement ability with respect to Regulation D, but even that would present difficult problems. Although he realized that suggesting legislative reform might seem an easy refuge in the search for a solution, and that legislation, especially involving fundamental changes, was hard to achieve, he doubted whether there could be any basic improvement in the situation in the absence of legislation.

Mr. Sanders observed that the Board's enforcement ability might be greater than indicated. For example, after the Comptroller of the Currency in late 1963 took the position that national banks could hold savings deposits for corporations, the Board, pursuant to authority in section 19, held that corporations were not eligible for savings accounts. Despite the Comptroller's position, there had not appeared to be any great rush by national banks to open savings accounts for corporations,
which might be an indication that a statement of the law was in itself a powerful deterrent.

Governor Maisel stated that perhaps he had not made his position clear. He believed there was too much stress on Regulation Q. The ceiling on interest rates was not the only way to approach the matter; there was also the authority over the amount of bank borrowings. Therefore, the question the Board must decide was which approach should be relied upon in order to promote the best banking system. Short-term notes should be classified on the basis of the answer to that question. It seemed to him that from the supervisory standpoint it would be better to classify the notes as borrowings rather than deposits; the limitations on borrowings were stricter. He could not see that issuance of the notes constituted an evasion of Regulation Q unless and until the Board had defined them as coming within the scope of the regulation.

Mr. Hexter commented that it seemed unquestionable that by prohibiting interest on demand deposits and giving the Board authority to determine what demand deposits were, Congress intended to cover the area. Under the banking practices now in question, a transfer of funds to a bank, which had always been regarded as a deposit, was being put in the form of a borrowing, on which interest was paid. To the extent that this practice was being permitted, the Board was countenancing evasion of the strong prohibition stated by Congress in section 19.
Governor Daane stated that, whereas he understood Governor Balderston's remarks to envisage mass competition for additional funds, the documentation presented to the Board seemed to assume principally a shift from certificates of deposit into short-term notes. If this was so, it would seem that the discussion should focus primarily on the relationship between these instruments. He inquired whether this reasoning was accepted by the staff.

Staff responses indicated that the impression Governor Daane had expressed reflected the flavor of the earlier studies by System committees, but that the problem was now looked upon also as one in which the use of short-term notes could burgeon over the use of certificates of deposit. It seemed probable that corporations might begin to choose some proportion of notes to certificates for purposes of diversification. However, the note was a new instrument in two respects: the notes could be issued for shorter maturities than certificates and thus would reach a new market; and a bank could pay more on a note than on a certificate because the note funds were not subject to maximum interest rate limitations or reserve requirements. The ability to pay a higher return would be likely to attract additional money, because some parties who would not buy a certificate of deposit might be attracted by several additional basis points on a short-term note.

Governor Daane then mentioned that Governor Mitchell had suggested on a previous occasion that in view of the maximum interest rate
limitation on certificates, unsecured notes could serve as a safety valve for banks faced with a liquidity problem. Although the Board's initial view, as reflected in its 1964 statement, might have seemed to give some credence to the safety valve theory, he wondered if that reasoning was accepted. If so, it might justify the Board's fostering this new instrument.

Mr. Brill expressed doubt whether this was the basis on which liquidity should be provided to the banking system.

After further comments were exchanged, Governor Daane stated that his preference would be to have the authority to prescribe maximum rates of interest placed on a standby basis and for the most part not in active use. However, as matters stood, the Board had responsibility for enforcing the existing law. Regardless of the Comptroller's position, he believed that the Board would appear in a poor light if it failed to make an effort to deal with an obvious evasion. Therefore, after going through the economic considerations, he came to the view that it was time to call a halt as far as possible. Much as he liked the idea of freedom of markets, he thought it was the part of wisdom for the Board, when it had some authority in this area, to use it. He could not see that the Board would gain in stature if it stood by and permitted member banks to go through this rather obvious subterfuge without protest.

Governor Balderston asked Governor Daane whether, if authority for Regulation Q had been put on a standby basis some years ago, he
would have favored reimposing interest rate restrictions in the face of the competitive race to acquire deposits in the past few years. If he would have, then the Regulation Q question might not really be relevant to the present discussion, and the essential question would be whether to prevent interest from being paid on demand deposits, or something akin to them.

Governor Daane said that in the situation of recent years he felt that he would have reimposed Regulation Q and tried to make it effective. Given the proper relationship among supervisory agencies, it could have been effective. This did not mean, however, that if authority to prescribe maximum rates of interest were on a standby basis he would not favor having it out of use for perhaps 80 per cent of the time.

At this point Governor Shepardson asked several questions, to which the staff responded, as to available means of enforcing Regulation D and as to supervisory controls that might be brought to bear through the examining function that would affect the movement of the banking system toward a position of less liquidity. It was indicated by the Division of Examinations that as a practical matter there appeared to be little available in the way of bank supervisory weapons to affect that movement.

Governor Shepardson then commented that, as he had observed on many occasions, particularly in connection with Regulation Q problems, unfortunately the Board was faced with many frustrations in being
responsible for administering laws that could not be effectively enforced. He was convinced that the issuance of short-term notes was being used as an evasion of the regulations. If the Board decided to amend its regulations to prevent that evasion, he thought it should do so with a realization that this was one part of the total pattern of frustrations. He did not see how it was logical for the Board to make an issue of the short-term notes unless it was prepared to take a stand on the entire front of the difficulties involved in carrying out its statutory responsibilities. Unless the Board was resolved to make a fight on the whole broad spectrum, the alternative was to continue along the lines it had followed thus far.

Mr. Molony observed that a good many public relations problems would be encountered. It was his view that the Board should not publish the proposed amendment in the Federal Register for comment unless it was strongly disposed to adopt it. Otherwise the Board's prestige would suffer.

Chairman Martin commented that although the discussion had been helpful, the problem had not been resolved. He would say personally that on the basis of this discussion the Board would make a mistake in going forward with the proposal at this juncture. However, the question should be brought up again when a full Board was available, and the Board could then decide whether or not it wanted to make a fight on the issue all the way down the line. If the Board made a decision
to move forward, it should be prepared to pursue the matter as far as required. As he had said, in his personal judgment this was a poor time to be taking such a step.

Governor Daane said that he would personally like to make the fight and that he thought there would be at least an even chance of winning it.

Chairman Martin then repeated that it would be advisable to wait until a full Board was available so that every member of the Board could be a party to the decision. If the Board took the suggested action, it must be prepared to fight the matter all the way through. Personally, he did not think the issue was sufficiently important in the broad spectrum of affairs to warrant such a decision, but if the Board decided to take the action he would be willing to go along -- the two sides of the problem could be argued indefinitely. The Chairman added the comment that in his opinion the concept of a free market had come to be little more than a nice ideal. He did not believe that the concept was crucial to the issue under discussion. In a sense, if the decision rested entirely on the free market concept, it could be said that the issuance of short-term notes was a good thing. The banks had claimed for years that others had been taking business away from them because of the stultified regulations under which the banks were forced to operate, and he saw a certain amount of merit in that claim.

After further discussion, it was understood that the proposal advanced in Governor Robertson's memorandum would be considered further at a meeting at which all members of the Board could be present.
All members of the staff then withdrew except Messrs. Kenyon, Molony, Fauver, Hackley, Johnson, Hexter, Sprecher, and Wood, and Mrs. Semia.

Employment practices at New York Bank. On August 12, 1965, there was preliminary discussion by the Board of a letter dated July 30, 1965, received in the Board's offices on August 11, from a lawyer for the Congress of Racial Equality (CORE) setting forth on behalf of CORE and the National Association for the Advancement of Colored People (NAACP) allegations of discriminatory employment practices on the part of the Federal Reserve Bank of New York.

There had now been distributed a memorandum dated September 9, 1965, in which the Division of Personnel Administration reviewed the findings of its exploration of the matter with the Federal Reserve Bank of New York and submitted a draft of reply to the incoming letter.

At the Board's request Mr. Johnson reviewed the list of the demands made by CORE and NAACP upon the Federal Reserve Bank of New York, described the individual cases upon which those organizations had based their more general allegations and the way in which the New York Bank had handled each case, and reviewed the relevant employment practices of the Bank. During the ensuing discussion various suggestions were made by members of the Board for changes in the approach and emphasis of the draft letter, principally for the purpose of conveying the thought that over the years the New York Bank had not only observed applicable
requirements of law but had taken a positive role in seeking to provide equal employment opportunities.

It was understood that a revised draft of reply would be submitted for the Board's consideration.

The meeting then adjourned.

Secretary's Notes: There was sent today to First National City Bank, New York, New York, a letter extending to April 1, 1966, the time for establishment of a branch in Callao, Peru. (A letter of September 17, 1964, had acknowledged the bank's notice of intent to establish this branch.)

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

Letter to the Presidents of all Federal Reserve Banks (attached Item No. 6) transmitting forms to be used by State member banks and their affiliates in submitting reports as of the next call date.

Letter to the Federal Reserve Bank of Dallas (attached Item No. 7) approving the appointment of Jerry A. Simpson as examiner.

[Signature]
Assistant Secretary
Board of Directors,
Wells Fargo Bank,
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to December 30, 1965, the time within which Wells Fargo Bank, San Francisco, California, may establish a branch in the vicinity of the intersection of 25th Street and MacDonald Avenue, Richmond, California.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
Board of Directors,
Wells Fargo Bank,
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to March 25, 1966, the time within which Wells Fargo Bank, San Francisco, California, may establish a branch in the Del Monte Shopping Center on Old Capitol Site on Carmel Hill, Monterey, California.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
Board of Directors,
Wells Fargo Bank,
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to March 6, 1966, the time within which Wells Fargo Bank, San Francisco, California, may establish a branch in the vicinity of the intersection of San Antonio Road and Alma Street, Mountain View, California.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.
September 15, 1965.

The Honorable A. Willis Robertson,
Chairman,
Joint Committee on Defense Production,
Congress of the United States,
Washington, D. C.

Dear Mr. Chairman:

In response to your letter of July 1, 1965, attached is a summary of mobilization activities of the Board of Governors for the year ending June 30, 1965.

The summary covers three major preparedness programs--the program for the continuity of the essential functions of the Federal Reserve System in the event of an attack on the United States, the program for bank preparedness, and the V-loan program.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Attachment
SUMMARY OF THE MOBILIZATION ACTIVITIES OF
THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
FOR THE YEAR ENDING JUNE 30, 1965

Introduction

This report summarizes the mobilization activities of the Board of Governors of the Federal Reserve System for the year ending June 30, 1965. It has been prepared at the request of the Joint Committee on Defense Production, Congress of the United States, and follows the outline suggested by the Committee. The report is divided into three Parts, each of which deals with a major preparedness program.

Part I describes the preparations of the Board and the Federal Reserve Banks to perform their essential functions and their Presidentially assigned emergency functions under all conditions of national emergency, including an attack upon the United States.

Part II describes the preparations of commercial banks, under the guidance of the Board and Federal Reserve Banks, to continue their essential banking operations in accordance with the emergency regulations of the Treasury, the Board, and the Federal Reserve Banks under all conditions of national emergency, including an attack upon the United States.

Part III describes Regulation V-loan activities and plans for the continuation of such activities on an expanded basis in a war emergency.

Part I

Preparations of the Board of Governors of
The Federal Reserve System and the Federal Reserve Banks
For War Emergencies.

1. Program. This program consists of preparations undertaken by the Board and Federal Reserve Banks pursuant to assignments from the President and the Director, Office of Emergency Planning, requiring the Board to:

a. Participate in the interagency development of emergency plans and preparedness programs, such as (1) The National Plan for Emergency Preparedness, (2) Federal Emergency Plan C (for limited or non-nuclear war situations), (3) Federal Emergency Plan D-Minus (for an attack situation), (4) The Digest of Federal Executive Branch Nonmilitary Emergency Measures, (5) the National Resources Evaluation Center program for the compilation and processing of resource data, (6) the Comprehensive Preparedness Program for State and Local Governments, and (7) Readiness Exercises.
b. Develop emergency plans and readiness to continue or resume the operations of the Board and Federal Reserve Banks under attack conditions, including provision for (1) the protection of personnel, property, and records, (2) lines of succession, (3) the temporary filling of war-caused vacancies, (4) the conduct of operations from alternate Headquarters, (5) the delegation of authority, and (6) the decentralization of operations; and

c. Develop plans and readiness to maintain the money, credit, and banking system under all conditions of war emergencies, including provision for (1) the supply and control of currency, (2) the extension and control of credit, (3) the collection of cash items and noncash items, (4) the conduct of fiscal and foreign financial operations, and (5) the financing of the Government in the event the normal measures for such financing are not available.


3. **Activities.** Activities during the past year in support of this program have involved all three of its principal elements; namely, interagency activities, preparation for continued operations, and preparations for the supply and regulation of money and credit. While attention continued to be given to preparations needed to cope with an attack situation, increasing emphasis was given to monetary and stabilization measures applicable to limited or non-nuclear war emergencies calling for varying degrees of mobilization.

\(^1\) Executive Order 11094 provides that the Board of Governors of the Federal Reserve System shall: (1) participate in the formulation of emergency financial policies; (2) prepare national emergency plans covering functions assigned by this order; and (3) develop a state of readiness for all conditions of national emergency including attack upon the United States. It further provides that the assignments shall be undertaken as an integral part of the Board's activities on the basis that it will have responsibility for them in an emergency, and that it shall be prepared to implement its plans.
a. **Interagency Activities.** The Board's participation in inter-agency preparedness activities continued to be extensive. The highlights of such participation are as follows:

(1) Drafted the "Economic Stabilization" chapter for the National Plan for Emergency Preparedness - completed during the past year;

(2) Assisted in the development of the Comprehensive Preparedness Program for State and Local Governments;

(3) Prepared a booklet "Emergency Plan for Maintaining the Money, Credit and Banking System in a Postattack Emergency" issued by the Office of Emergency Planning to acquaint State and Local officials, industry, and the public with this important element of preparedness. The booklet contains a compendium of relevant emergency regulations;

(4) Reviewed State Emergency Plans to assure their consistency with the emergency financial policies and regulations of the Federal Government;

(5) Prepared the section on economic objectives and control measures applicable to limited or non-nuclear war situations for incorporation in the Digest of Federal Executive Branch Non-Military Measures. This section is comparable to the one containing objectives and measures applicable to a general or nuclear war situation referred to in last year's report; and

(6) Maintained liaison representation with the Special Facilities Division and the National Resources Evaluation Center of the Office of Emergency Planning; and further contributed to interagency preparedness activities through participation in the monthly meetings of the Interagency Emergency Preparedness Committee.

b. **Continuity of Operations.** Plans for the continuity of operations are set forth in the Emergency Plans of the Board and Federal Reserve Banks. These Plans are reviewed annually and revised as necessary to keep them current.
For the protection of personnel, the National Shelter Policy has been applied to Federal Reserve buildings since 1958. All of the System's 37 buildings, except one, contain areas with adequate shielding to be utilized as fallout shelters. Personnel located in the one-building lacking adequate shielding have been instructed to use a nearby shelter in an emergency. Facilities to improve the habitability of shelter areas have been installed in 26 shelters--three of which were completed this year. Based on a recent survey, shelter supplies, including emergency food arrangements, were found to be satisfactory.

For the purpose of obtaining as much advance warning of an attack as possible, provision has been made for the receipt and dissemination of Defense Readiness Conditions (DEFCONs), declared by the Joint Chiefs of Staff on the basis of the seriousness of any war threat. DEFCON warnings are transmitted over a special communications system known as DEFCORD. The Board's receiving device on the DEFCORD system is located in the Guard's Headquarters where it is attended at all times. During this past year this warning system was tested at least once every 24 hours.

In order to make the best use of any time afforded by DEFCON warnings, the Board and Reserve Banks maintain lists of actions to be taken on receipt of such warnings. Actions include steps to activate alternate offices and measures to prevent or control panic among consumers and depositors, if such should develop.

Provision has been made for the orderly transfer of operations from regular offices to alternate offices in the event the use of regular offices should become untenable following an attack. The alternate offices have been selected with a view to their being in reasonable proximity to regular offices, yet sufficiently distant from target areas so as to avoid blast and thermal effects of weapons detonated in such areas. These principles for selecting alternate offices require that the facilities contain considerable built-in protection, or that their locations be periodically reviewed for vulnerability in the light of the nuclear attack hazard studies, "NAHICUS", prepared by the Department of Defense. Heretofore, it has been necessary to make several changes in the location of alternate offices due to their proximity to SAC bases, and missile (ICBM) sites. At present,
changes are being made in the location of three alternate offices. Considerable thought is being given to finding ways and means of utilizing communication and computer facilities in such a manner as to simultaneously improve the readiness of emergency facilities and the efficiency of peacetime operations.

(5) Duplicate records needed for the continuity of operations are maintained currently at alternate offices or at nearby record storage centers. These records are tested for operational purposes at least once a year. During the current year, Open Market, Cash, and Check balances were reconstructed from the duplicate records in order to keep personnel acquainted with reconstruction procedures.

(6) Emergency lines of succession have been established for the filling of war-caused vacancies. The names of individuals in line of succession are periodically reviewed to determine their current availability.

(7) In order to further assure that the functions of the Board and Reserve Banks could be performed—even if all of the measures described above should fail—the Board has made contingent delegations of its authority to surviving members of the Board, an interim Board, and the Federal Reserve Banks. The Federal Reserve Banks, in turn, have made contingent delegations to other Reserve Banks and, for certain purposes, to emergency Cash Agents and Check Agents. A current review of Cash and Check Agent arrangements resulted in the designation of one additional Check Agent and the designation of several substitute Cash Agents, the total now being 424 Check Agents and 261 Cash Agents.

c. Regulation of Money and Credit. Executive Order 11094 provides that emergency financial plans shall be developed in consonance with the Government’s emergency financial policies. These policies require, inter alia, that provision be made for (1) the continuance of banking operation, (2) liquidity, (3) adequate supplies of currency (4) the availability of bank deposits and new bank credit for essential purposes, (5) the clearance of checks, including those drawn on destroyed banks, and (6) the equitable sharing of war losses. Major actions to implement these policies are listed below:

(1) The Secretary of the Treasury has (1) delegated to the Board "authority and power to take such action consistent with regulations issued by the Secretary . . . as may be necessary to maintain, regulate
limit, or suspend the operation and functioning of any banking institution." (2) issued Treasury's Emergency Regulation No. 1 requiring banks to remain open, authorizing loans between banking institutions without regard to normal restrictions, and limiting withdrawals of cash, transfers of bank balances, and extensions of credit to amounts needed for specified essential purposes, (3) provided Federal Reserve Banks with authority and instructions for the conduct of Emergency Fiscal Agency functions, and (4) prepared a Fiscal Service Emergency Regulation No. 1 providing relief for U.S. securities destroyed or made inaccessible as a result of an attack. (This Fiscal Service Emergency Regulation has not been signed pending legislative authority)

(2) The Board has issued its Emergency Regulations Nos. 1 and 2 authorizing Federal Reserve Banks to (1) conduct operations from alternate offices, (2) act for other Federal Reserve Banks, (3) designate emergency Cash and Check Agents, (4) prescribe emergency rules to facilitate the collection of checks, (5) make credit available to both member and nonmember banks, and to individuals, partnerships and corporations when not otherwise available for essential purposes, (6) purchase and sell U.S. securities on their own accounts, (7) purchase and sell due bills and pledge such bills as collateral for Federal Reserve Notes, (8) reduce the gold certificate reserve requirement, (9) raise or lower reserve requirements and extend such requirements to nonmember banks, (10) waive penalties on deficient reserves, and (11) take such actions as Fiscal Agents of the U.S. as authorized by the Secretary of the Treasury.

(3) After providing the authorizations needed for the complete decentralization of operations, the Board provided the Federal Reserve Banks with "Guidelines on Emergency Monetary Policy" designed to keep decentralized operations as uniform as possible. The Guidelines include policies on discount administration and rates, purchase and sale of Government securities, reserve requirements, selective credit controls, and methods for dealing with problems of excess liquidity.

(4) The Federal Open Market Committee has delegated authority to Federal Reserve Banks and provided them with guidance for conducting transactions in U.S. Government securities, providing the Treasury with adequate funds to finance emergency needs, and
facilitating the reactivation of Open Market operations as soon as possible. Throughout this reporting period, Federal Reserve Banks have been supplied daily with such duplicate records as necessary to reconstruct Open Market and foreign exchange accounts. As indicated in paragraph b (5) above, Reserve Banks reconstructed these records at least once during the past year to keep their personnel trained for emergency operations.

(5) In accordance with Planning Guidelines for 1965, and prompted by developments in Vietnam, the Board and Federal Open Market Committee have given attention to possible monetary policy responses to limited or non-nuclear war emergencies. Money market and central bank reactions to such World War II incidents as the invasion of Poland have and are being reviewed against the background of our current economy with a view to expediting appropriate decisions in the event incidents leading to large scale conventional warfare should occur.

(6) Federal Reserve Banks, heretofore, completed the distribution of emergency circulars to all banking institutions. These circulars are designed to provide the banking system with advance information on post-attack banking operations. They include instructions on (1) distribution and control of currency and use of emergency Cash Agents, (2) availability and control of bank balances, collection of checks, and the use of emergency Check Agents, and (3) extension and control of credit. During the past year these circulars were revised, as necessary, to keep them current.

(7) In implementing the Government's policy for the maintenance of an adequate supply of currency, a two-year's supply goal was established based on an estimate that two years would elapse before the Bureau of Engraving could resume production if it were to be destroyed. In order to spread the risk, emergency currency supplies are decentralized to the vaults of the Federal Reserve Banks and Branches and in some instances to the vaults of emergency Cash Agents. During the past year the amount of the two-year supply goal was revised upward in accordance with the amount of currency currently paid into circulation during 1963-64. Also Federal Reserve vaults were surveyed to determine space available for the storage of additional supplies and the relative vulnerability of said vaults as indicated by the nuclear attack hazard (NAHICUS).
studies. As a result of the survey, new storage goals, which take account of vulnerability, were established for Federal Reserve vaults and Reserve Banks were requested to bring their currency inventories up to said goals. In addition, $40 million of currency was prepositioned in the vaults of selected emergency Cash Agents during the year, making a total amount of $279.8 million so prepositioned.

4. Effectiveness. The effectiveness of the program has been tested against a variety of possible attack patterns. The results indicate that the measures being taken give reasonable assurance that the essential wartime functions of the Federal Reserve System in support of the money, credit, and financial system can be maintained in a post-attack emergency.

5. Current Need. The program will be needed as long as any potential enemy has the capability of launching a massive nuclear attack upon the United States. The program contributes to the overall defense posture of the nation, to the effectiveness of the family of deterrents to attack, and to the nation's preparedness to maintain the money and credit system if attacked.

6. Small Business. The program for the continuity of the essential wartime functions of the Federal Reserve System relates directly to the Board and Federal Reserve Banks, and indirectly to banking institutions and other businesses large and small capable of making a contribution to the war effort and reconstruction. Since it is assumed that the large cities, the industrial-population concentrations, and financial centers might be the natural objects of attack with weapons of mass destruction, emphasis has been placed on the preparation of small banking institutions outside of the more vulnerable target areas to serve the enterprises upon which reliance must be placed to support military, civil defense, and reconstruction operations.

7. Major Problems. The lack of a plan for the equitable sharing of war losses, one of the emergency financial policies, has been identified as the only major problem in the last three of our annual reports. Such a plan is believed to be the most practical means of providing the solvency necessary for a "going-concern" economy following an attack. The lack of such a plan jeopardizes the effectiveness of all other preparations for the maintenance of our money, credit, and banking system. Executive Order 11094, section 3, provides that the Board shall participate with the Office of Emergency Planning and the Department of the Treasury in the development of plans and procedures for the sharing of war losses. The Board is not aware of any activities in connection with such developments during the past year.
8. Program Changes. No change in the program is contemplated. Changes in ways and means for furthering the program will be made as needed, particularly as needed to meet changes in enemy capabilities.

9. Standby Programs. There are two programs which might properly come under this heading. One pertains to the equitable sharing of war losses, mentioned above; the other pertains to the post-attack utilization of bank examiners. The three Federal supervisory agencies, together with the Federal Reserve Banks, have agreed to look to their examination personnel as the primary source of reserve manpower. They have further agreed that this manpower should be utilized in a cooperative manner to meet the most urgent needs, including staffing requirements of Federal Reserve Banks, emergency Check Agents and Cash Agents, and banking institutions which may have difficulties in continuing or re-establishing operations.

10. Organizational Changes. There have been no organizational changes for administering this program during the past year.

11. Future Objectives. Future objectives are to keep our preparedness measures current and to constantly improve our readiness. On the basis of foreseeable needs to cope with increasing missile capabilities and decreasing warning time, emphasis will be placed on: (1) Defense Readiness Conditions (DEFCONs) procedures, (2) improving fallout protection, (3) modifying relocation arrangements as necessary to meet changing estimates of vulnerability, (4) remain ready to participate in the development of plans for the sharing of war losses, when requested, and (5) continue to maintain adequate currency supplies for every emergency.

12. Availability of Funds. Funds are made available as needed to carry on the preparedness responsibilities of the Board and the Federal Reserve Banks. Since the operating funds for the Board and the Banks are not derived from Congressional appropriations, the Board has sought to limit expenditures to those kinds of needs which Congress has approved in making appropriations to other agencies.
Part II

Preparedness of Commercial Banks
For a War Emergency

1. Program. The Board is responsible for the development of plans, in cooperation with the Department of the Treasury and the Federal Deposit Insurance Corporation, to encourage preparedness by "banking institutions" in order to assure the continuity of their operations in the event of enemy attack.

2. Authority. The authority for the conduct of this program is derived from Executive Order 11094, February 26, 1963.

3. Activities. Activities under this program relate to (1) providing guidance to banking institutions on preparedness measures, (2) encouraging banking institutions to take effective action on the guidance given, and (3) monitoring such action.

a. Guidance. General guidance on both preattack preparedness measures and postattack banking operations, prepared by the Banking Committee on Emergency Operations with the approval of Federal and State bank supervisory agencies, has been distributed to all banks. This general guidance has been supplemented with detailed instructions on postattack banking operations contained in emergency circulars issued by the Federal Reserve Banks, more particularly described in Part I, 3, c, (6).

b. Promotion. Heavy reliance has been placed upon the willingness of bankers to voluntarily take the preparedness actions needed to continue operations postattack. They have been urged by the Secretary of the Treasury, Federal and State supervisory authorities, Federal Reserve Banks, bank examiners, and bankers' associations to establish preparedness programs suitable to their location and size. Banks located in probable target areas have been urged, as a minimum, to establish duplicate record programs. Banks located outside the blast and thermal effects of weapons detonated in probable target areas have been urged, as a minimum, to provide fallout protection, as recommended by the Office of Civil Defense.

c. Monitoring Progress. In order to keep abreast with the progress being made by banks in improving their readiness to serve the nation in the event of an attack, bank examiners inquire as to
what is being done in the course of regular examinations. The emergency preparedness information contained in the examiners' reports is tabulated by the Board according to the classification, location, and size of banks.

4. Effectiveness. Progress over the past six years is indicated by the following table:

<table>
<thead>
<tr>
<th>Yr. Ending</th>
<th>Banks Reporting</th>
<th>Banks with Preparedness Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30</td>
<td></td>
<td>Number</td>
</tr>
<tr>
<td>1960</td>
<td>13,464</td>
<td>826</td>
</tr>
<tr>
<td>1961</td>
<td>13,364</td>
<td>916</td>
</tr>
<tr>
<td>1962</td>
<td>13,345</td>
<td>1410</td>
</tr>
<tr>
<td>1963</td>
<td>13,466</td>
<td>2007</td>
</tr>
<tr>
<td>1964</td>
<td>13,582</td>
<td>2471</td>
</tr>
<tr>
<td>1965</td>
<td>13,616</td>
<td>2551</td>
</tr>
</tbody>
</table>

The poor progress shown for the year ending June 30, 1965 is due, in part, to the fact that the "Emergency Preparedness Measures" questionnaire was dropped from the revised National Bank Examination Report form as of September 1, 1964; consequently there are no current preparedness reports on National Banks examined between September 1, 1964 and April 1, 1965 when National Bank examiners were instructed to request banks, at the time of their examination, to complete the questionnaire and forward it directly to the Board. Of the 4,662 National Banks included in the tabulation, no progress can be shown on 2,879 because there are no current preparedness reports on these banks.

On the encouraging side, preparedness on the part of banks representing more than 80 per cent of total deposits is improving in quality. The number of banks reporting the completion of their duplicate records program has increased. Participation by banks having $1 billion or more deposits is still 100 per cent even though the number of such banks increased from 29 to 35. An analysis of commercial bank preparedness in relation to vulnerability, as shown by the nuclear attack hazards (NAHICUS) studies, indicates that the percentage of banks located in vulnerable areas having preparedness programs is more than twice that of banks located in areas having little or no probability of blast damage.

5. Current Need. The current need for this program is based on the belief that a functioning banking system would be essential to the nation in time of war, and that the achievement of adequate preparedness in time of peace is needed to assure the continued functioning of bank operations in the event of nuclear attack.
6. Small Business. The program relates directly to banking institutions, large and small, and indirectly to the entire economy, to small business as well as large. Small banks located in less vulnerable areas must be prepared to assume a larger role in a postattack emergency as a result of possible damage to large banks in more vulnerable areas.

7. Major Problems. The major problems in carrying out the program and (1) lack of realization on the part of many banks of the need for preparedness measures because of their seemingly secure locations, (2) lack of uniform effort among supervisory agencies in the promotion of bank preparedness, and (3) a tendency to let preparedness activities drag during periods of quiescence in international tensions.

8. Program Changes. No program changes are contemplated.

9. Standby Programs. The entire program is a standby program. It is directed toward preparedness for any future emergency.

10. Organizational Changes. No organizational changes for the promotion of the program are contemplated.

11. Future Objectives. The future objective is to continue the promotion of the program, largely by overcoming the major problems set forth above.

12. Availability of Funds. There has been no lack of funds for the promotion of this program.
Guaranteed Loan Program

1. **Program.** The Federal Reserve Banks, under regulations of the Board of Governors, act as fiscal agents of the United States in connection with the V-loan program for Government guarantees of defense production loans. The Board of Governors, after consultation with the guaranteeing agencies, prescribes fees, rates, and procedures to be utilized in connection with such guarantees.

2. **Authority.** The present V-loan program was inaugurated under authority of the provisions of section 301 of the Defense Production Act of 1950, approved September 8, 1950, and the President's Executive Order 10161, dated September 9, 1950. The original Executive Order was superseded by Executive Order 10480, dated August 14, 1953, and Executive Order 10819, dated May 8, 1959. Under the law, as amended by the Defense Production Act Amendments of 1964, authority for the program, unless further extended, will terminate on June 30, 1966.

3. **Activities.** Pursuant to the law and Executive Orders of the President, certain designated procurement agencies of the Government are authorized to guarantee loans made by private financing institutions to finance contractors, subcontractors, and others engaged in the performance of Government defense contracts for the purpose of expediting production and deliveries or services for the National defense. By an amendment made by the Defense Production Act Amendments of 1953, guarantees may also be issued with respect to loans made to finance contractors and subcontractors or other persons in connection with or in contemplation of the termination of their defense contracts.

At the outset of the program, the designated guaranteeing agencies were the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, and the General Services Administration. In 1951, the Atomic Energy Commission and Defense Materials Procurement Agency were also designated as guaranteeing agencies. By Executive Order 10480 of August 14, 1953, the Defense Materials Procurement Agency was abolished and its functions transferred to the General Services Administration. By Executive Order 10819, dated May 8, 1959, the National Aeronautics and Space Administration was designated as a guaranteeing agency. By Executive Order 11062, dated November 19, 1962, and a directive of the Department of Defense, dated December 8, 1962, the Defense Supply Agency of the Department of Defense was designated as a guaranteeing agency.

On June 30, 1965, credit available under guarantee agreements outstanding totaled $69,524,000. Of this amount, approximately 78 per cent on the average was guaranteed by the Government. On June 30, loans outstanding amounted to $54,913,000, and there was
available to borrowers an additional $14,611,000. Available credit under the guarantee agreements outstanding by the various agencies was as follows:

<table>
<thead>
<tr>
<th>Agency</th>
<th>Available Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of the Army</td>
<td>$ 8,026,000</td>
</tr>
<tr>
<td>Department of the Navy</td>
<td>29,272,000</td>
</tr>
<tr>
<td>Department of the Air Force</td>
<td>32,226,000</td>
</tr>
</tbody>
</table>

From the beginning of the program to June 30, 1965, net income of the guaranteeing agencies from guarantee and commitment fees and interest on purchased loans, after deducting established losses and expenses of the Federal Reserve Banks as fiscal agents, was as follows:

<table>
<thead>
<tr>
<th>Agency</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of the Army</td>
<td>$ 5,378,000</td>
</tr>
<tr>
<td>Department of the Navy</td>
<td>12,042,000</td>
</tr>
<tr>
<td>Department of the Air Force</td>
<td>14,840,000</td>
</tr>
<tr>
<td>Defense Supply Agency</td>
<td>-1,000</td>
</tr>
<tr>
<td>General Services Administration</td>
<td>6,266,000</td>
</tr>
<tr>
<td>Atomic Energy Commission</td>
<td>509,000</td>
</tr>
<tr>
<td>Department of Commerce</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Total net income</strong></td>
<td><strong>$39,040,000</strong></td>
</tr>
</tbody>
</table>

The Department of the Army estimates that of the loans it has purchased approximately $414,000 is uncollectible. The Department of the Navy estimates that of the loans it has purchased approximately $1,389,000 is uncollectible. The Department of the Air Force estimates that of the loans it has purchased approximately $400,000 is uncollectible. Assuming these estimated losses are realized, the net income to the Government at this time on the guaranteed loan program is over $36 million. The relatively small net incomes of Atomic Energy Commission and Department of Commerce, as well as the excess of expenses of the Defense Supply Agency, reflect smaller activity in the program rather than unsatisfactory experience.

There has existed since the inauguration of the V-loan program complete cooperation and understanding between the guaranteeing agencies, the staff of the Board of Governors, and the Federal Reserve Banks. Any differences that have arisen have been promptly settled and the primary purpose in the minds of all connected with the program has been to facilitate the financing of defense contractors as provided in section 301 of the Defense Production Act of 1950, as amended, and the implementing Executive Orders.

4. Effectiveness. The guaranteed loan program was successful and fulfilled a useful purpose during World War II and during the Korean conflict. It has continued to be useful in support of defense production, but on a more limited scale. It provides a mechanism whereby defense contractors and subcontractors, particularly small business concerns, can arrange to borrow the funds necessary to finance their
defense production through their local banks by means of Government guaranteed loans rather than through the advance of Government funds or direct Government loans.

From the beginning of the program in September 1950 through June 30, 1965, 1,628 loans totaling $3,497,210,000 were authorized by the procurement agencies which guarantee such loans.

During the 12 months ending June 30, 1965, there was disbursed on outstanding loans approximately $119,188,000, most of which was revolving credits.

5. Current Need. The current need for this program may be drawn from its current activity and the desirability of being ready to support an expanded procurement program when needed.

The following tabulation shows the number and amount of guaranteed loans authorized at the end of each month in the period June 1964 through June 1965.

<table>
<thead>
<tr>
<th>Guaranteed loans authorized to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (In thousands of dollars)</td>
</tr>
<tr>
<td>Number</td>
</tr>
<tr>
<td>June 30</td>
</tr>
<tr>
<td>July 31</td>
</tr>
<tr>
<td>August 31</td>
</tr>
<tr>
<td>September 30</td>
</tr>
<tr>
<td>October 31</td>
</tr>
<tr>
<td>November 30</td>
</tr>
<tr>
<td>December 31</td>
</tr>
</tbody>
</table>

6. Small Business. Classifications of guaranteed loans by size of the borrower were discontinued beginning 1960 due to the relative inactivity of the program. At that time, (see report for last quarter 1959) approximately three-fourths of the number of loans authorized were to borrowers having less than 500 employees. It is believed that this proportion of loans to small business has not significantly changed.

7. Major Problems. There are no major problems confronting the Board and Federal Reserve Banks in carrying out this program.
8. **Program Changes.** The Federal Reserve Banks have plans to conduct the essential operations of the Banks from relocation offices in the event of an emergency. The Reserve Banks plan to continue to perform such fiscal agency functions under the V-loan program as the situation then prevailing permits.

9. **Standby Programs.** Plans contemplate that the Federal Reserve Banks and the Board will be prepared to participate in an expanded program suitable to any future emergency needs.

10. **Organizational Changes.** There have been no organizational changes in the conduct of this program during the past year.

11. **Future Objectives.** As stated in section 301 of the Defense Production Act, the objective of the guaranteed loan program continues to be "to expedite production and deliveries or services under Government contracts."

12. **Availability of Funds.** The guaranteeing agencies are authorized to use any moneys appropriated to them for defense purposes to meet any costs and expenses in connection with the V-loan program. The availability of funds is adequate.
September 15, 1965.

Mr. Eliot J. Swan, President,
Federal Reserve Bank of San Francisco,
San Francisco, California. 94120

Dear Mr. Swan:

In a letter dated August 17, 1965, to you, President Tweter of United California Bank of Los Angeles, California, requested that certain information about management incorporated in an application of that bank to merge with The Feather River National Bank be held confidential and not made part of any public record. In the Board's Statements in merger cases care is taken to avoid the disclosure of nonessential information, and it is probable that the Board would allude to initial management of The Feather River National Bank only in general terms. It is conceivable, however, that circumstances might arise that would require disclosure of more detailed information and the Board cannot commit itself to hold as confidential the information about management submitted in connection with this proposed merger. Please convey the substance of this letter to President Tweter.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.
Dear Sir:

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

Number of copies

Form FR 105 (C.11 No. 177), Report of Condition of State member banks.

Form FR 105e (Revised February 1961), Publisher's copy of report of condition of State member banks.

Form FR 105e-1 (Revised February 1961), Publisher's copy of report of condition of State member banks.

Form FR 220 (Revised March 1952), Report of affiliate or holding company affiliate.

Form FR 220a (Revised March 1952), Publisher's copy of report of affiliate or holding company affiliate.

The forms are identical to those used for the April 26, 1965, call date and exclude the schedules on the reverse, except for the items required for deposit insurance assessment purposes and the affiliate schedule. The same form is being printed by the Federal Deposit Insurance Corporation for distribution to insured nonmember State banks.
The form to be distributed to national banks by the Comptroller of the Currency is expected to be the same as that used for the April 26, 1965, call date and thus will differ in several respects from the form being used by State banks. There are no plans to collect supplementary information from national banks for the purpose of reconciling these differences. Under these circumstances, it is not planned to make computer tabulations of the data in Washington, and it will therefore not be necessary to keypunch these reports.

Very truly yours,

[Signature]
Kenneth A. Kenyon,
Assistant Secretary.

Enclosures.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.
Mr. Thomas R. Sullivan, Vice President,
Federal Reserve Bank of Dallas,
Dallas, Texas. 75222

Dear Mr. Sullivan:

In accordance with the request contained in your letter of September 10, 1965, the Board approves the appointment of Jerry A. Simpson, at present an assistant examiner, as an examiner for the Federal Reserve Bank of Dallas, effective October 1, 1965.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.