

Minutes for September 22, 1965

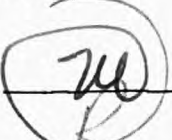
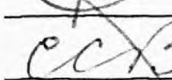
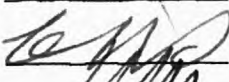

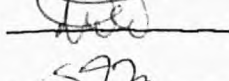
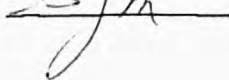

To: Members of the Board

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 Wednesday, September 22, 1965. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. 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. Solomon, Director, Division of Examinations  
Mr. Hexter, Assistant General Counsel  
Mr. Sammons, Adviser, Division of International  
Finance  
Mr. Sanders, Senior Attorney, Legal Division  
Mr. Egertson, Supervisory Review Examiner,  
Division of Examinations

Branch applications (Items 1 and 2). Pursuant to the recommendations contained in files that had been distributed, unanimous approval was given to applications by Mountain Trust Bank, Roanoke, Virginia, and Citizens Bank and Trust Company, Blackstone, Virginia, to establish certain in-town branches. Copies of the letters sent to the respective banks are attached as Items 1 and 2.

New York State Dormitory Authority bonds. As stated in a distributed memorandum from the Legal Division dated September 17, 1965, the Federal Reserve Bank of New York had requested the Board to issue a ruling to the effect that the 10 per cent investment limitation of

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section 5136 of the Revised Statutes of the United States could be applied separately to New York State Dormitory Authority bonds issued for a particular college, provided that such bonds were in effect actually repayable solely by the college. Such a ruling, if issued, would be based upon an interpretation of the meaning of "obligor or maker" as used in the seventh paragraph of section 5136, which among other things limits the extent to which a national bank may invest in the obligations of one "obligor or maker" to 10 per cent of the bank's capital stock and surplus. This limitation is made applicable to State member banks by section 9 of the Federal Reserve Act.

The proposed ruling would be consistent with a ruling by the Comptroller of the Currency. The Reserve Bank believed that the Comptroller's ruling was compatible with the underlying purpose of the statutory limitation, namely, the maintenance by member banks of sound, diversified investment portfolios. Nevertheless, the Reserve Bank apparently considered that the legality of the Comptroller's ruling was not free from doubt because it hesitated to apply the 10 per cent limitation to New York State Dormitory Authority bonds held by State member banks in the manner indicated in the Comptroller's ruling without a determination by the Board to such effect.

The purpose of the proposed ruling would be to permit a State member bank to invest up to 10 per cent of its capital and surplus in each portion of obligations issued by the State Dormitory Authority with

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respect to which a different college had entered into an agreement to make payments to the Authority sufficient to cover interest and principal when due. This purpose appeared to the Legal Division not to be in accord with the language of section 5136, which states that "In no event shall the total amount of the investment securities of any one obligor or maker" exceed the percentage limitation. The Division's memorandum pointed out that any person legally bound to make payment of principal and interest on an obligation when due is an obligor; any person executing an obligation is a maker; and an obligor or maker does not cease to be such by entering into a contract with a third person intended to assure to the obligor an income sufficient to cover principal and interest on the obligations when due.

It did not appear that bonds issued by the Authority for projects at various colleges were actually repayable solely by the college concerned. Instead, it appeared that the bonds were general obligations of the Authority payable from and secured by pledges of the revenues of the project, and that the full faith and credit of the Authority was pledged to the payment of principal and interest on the bonds. If a college did not fulfill its agreement, the Authority would be obliged to pay or there would be a default on the obligation. To fulfill its obligation the Authority might have to acquire funds through the exercise of its general borrowing power. Consequently, the Legal Division believed that a bank that invested in such bonds must be considered as doing so at least partially on the basis of the credit standing of the Authority.

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It was recommended that the Board advise the New York Reserve Bank that the Board proposed to issue a ruling on the meaning of "obligor or maker," as used in section 5136, in accordance with which bonds issued by the New York State Dormitory Authority for a particular college would have to be included in determining the extent of a State member bank's investment in obligations of the Authority, even though such obligations probably would be paid solely from revenues received by the Authority from the college. A draft of letter was submitted with the memorandum.

It was also recommended that the proposed interpretation be submitted to the Comptroller of the Currency and the Federal Deposit Insurance Corporation for comment, and brought to the attention of the interagency committee that had been established to consider conflicting positions of Federal bank supervisors. A draft of the proposed interpretation was submitted with the memorandum.

After comments on the matter by Mr. Sanders, there ensued a lengthy discussion during which inquiry was made as to whether the State Authority was a co-signer on the bonds described or whether it was the principal maker. Mr. Sanders replied that the Authority was the only signer and that the individual colleges did not sign the bonds at all. Question then was asked whether the revenue of each college was pledged against a particular bond, to which Mr. Hexter replied that if a certain college had sufficient revenue to service its bonds but some other college did not, he thought the holders of the bonds of the first college would obtain full payment.



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Governor Daane inquired whether the legal staff was fully in agreement on the position it had recommended. He wished there was some way, in this instance, in which the Board could come out at the same place as the Comptroller of the Currency. If the legal issue was so clear as to offer no alternative, that was one thing. Otherwise, however, he would see merit in consistency.

Governor Shepardson inquired whether the bonds were of a uniform nature or whether each group related to an individual college, in reply to which Mr. Hexter said there was a separate issue for each dormitory involved. The income of the particular college concerned would go in the first instance toward payment of principal and interest on the obligations. If this income was sufficient, that would take care of the demands on the particular issue.

Governor Robertson inquired whether the State Dormitory Authority had any way of raising funds other than through the promise of each individual college, and the answer given was in the affirmative.

Question was raised whether the dormitory issues were general obligations or revenue bonds, with the answer given that they were stated to be general obligations even though they might have some of the characteristics of revenue bonds. It was pointed out that the mere fact of allocation of a particular source of income to service bonds did not diminish the obligation of an issuer to pay principal and interest, if necessary, from any source available to it; this was often the case with respect to municipal bonds.

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Mr. Hackley stated that, as he understood it, in the present case the individual colleges were not liable on the bonds, these being bonds issued by the State Dormitory Authority. He went on to say that the provision of law here involved related only to the limitation on the percentage of a bank's capital and surplus that could be invested in the obligations of one obligor or maker. In a hypothetical case, it might be assumed that this limit was \$1 million, but the Dormitory Authority might issue five series of bonds for five different colleges totaling \$5 million. Under the Comptroller's ruling, the implication was that the bank would be permitted to invest in such bonds up to \$5 million, instead of \$1 million, but as a matter of fact the obligor on all of these issues was the Authority itself. In view of the language of the statute, it was difficult to see that this was not an investment in excess of the bank's \$1 million limitation. The statute related not to the source of funds to pay principal and interest or to the security underlying the bonds, but to the amount that the bank could invest in the obligations of a single obligor.

In response to a question, Mr. Hackley said he interpreted the intent of the statute to be that of preventing a concentration of loans to one borrower and requiring diversification. It might be argued that in light of the underlying intent of the statute it would not be objectionable to permit what was implied by the Comptroller's ruling in the present instance, but the plain language of the statute seemed to prohibit it.

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Governor Daane then said that he did not view the position taken by the Comptroller as contrary to the intent and objective of the statute. If the Board took an opposite position, he felt that it would be put in an unfavorable light. He doubted that a State member bank that acquired bonds of the individual colleges would put itself under undue risk.

Governor Maisel agreed with Governor Daane, adding that if the State Dormitory Authority was not in the picture the issues of the several colleges would be weaker obligations. As things stood, an authority was involved that had additional powers to raise revenue, thus making the bonds stronger. But the ruling proposed by the Legal Division would reduce the amount of the bonds that a State member bank could hold, which seemed inconsistent.

After further discussion of the Comptroller's ruling, question was raised about the position of the New York Reserve Bank. Mr. Hexter said he had discussed the matter with attorneys for the Bank. He understood it to be their position that while under section 5136 it would not be permissible to extend credit beyond the 10 per cent limit on investment in the obligations of one "obligor or maker," they wanted to know the Board's views in this instance in light of the Comptroller's ruling.

Mr. Solomon's views were then requested. He said that other things being equal he doubted that the purpose of the statute would be infringed by permitting State member banks to invest up to 10 per cent of their capital stock and surplus in the bonds of each individual college.



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If no over-riding principle would be violated, he saw some advantage in trying to find a means of achieving consistency with the Comptroller's interpretation. He was impressed by the point that the actual source of funds was to be the individual college. In one sense, at least, the bonds reflected borrowing by the individual colleges but in order to strengthen the credit the bonds carried the additional support of the State Authority. He realized that legal arguments could be made against taking such a view. If this had come up as an original legal proposition, he might be inclined the other way, but he felt there was some justification for deciding between possible alternatives in the direction of consistency.

Chairman Martin observed that it appeared from the memorandum that the New York Reserve Bank favored the Board's issuing a ruling along the lines of the Comptroller's ruling.

Mr. Hackley said he understood the New York Bank's position to be similar to that of Mr. Solomon. In the interest of consistency the Bank would like to see the Board make a similar ruling, but as a legal matter he felt that the Bank agreed with the Board's legal staff.

Mr. Hackley also commented, in broader terms, that the Board had ruled that capital notes and debentures of banks could not be regarded as stock for certain purposes of the statute. The Comptroller had taken the other position, and there was much to be said for it. However, the Board had felt that it was not within the Board's prerogative to rewrite

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the statute. Somewhat the same situation prevailed here. As a matter of judgment it might be said that the intent of the law would be carried out by taking a position similar to that of the Comptroller. But the law, read literally, seemed contrary to the Comptroller's position. If the Board wished to construe the statute in the light of its judgment as to what the statute should say and what it thought the Congress intended, this would change the whole approach to various provisions of the law. It might be unfortunate to have to disagree with the Comptroller in a case of this kind, but agreement with the Comptroller's position would amount, in effect, to construing the law according to a judgment of what the law should be.

Governor Daane asked if that was strictly true in this particular case. In its various interpretations the Board had endeavored to stand by the intent of the Congress. In this case he felt that the recommended position would run somewhat counter to the basic Congressional intent.

After further discussion of the problem, Governor Maisel referred to the statement in the Legal Division's memorandum attributing to the Reserve Bank the view that "the Comptroller's ruling is consistent with the underlying purpose of the statutory limitation contained in paragraph Seventh of Section 5136, i.e., the maintenance by member banks of sound, diversified investment portfolios."

Mr. Hexter remarked that the Legal Division could check again with the Reserve Bank. However, in conversations with staff of the Bank

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he had received the definite impression that the Bank felt that what seemed contemplated by the Comptroller's ruling was not legally permissible.

Governor Robertson observed that Mr. Hexter had been talking with the Reserve Bank's lawyers, whereas the statement quoted by Governor Maisel apparently came from the Reserve Bank as such.

Governor Robertson then commented that care should be exercised not to interpret the laws on the basis of assumptions rather than on the basis of what the law said. In this case the language of the law was clear, and he did not see how one could deviate from it.

Governor Maisel said that, as indicated by his previous comments, he believed that it would be reasonable in this instance to make a liberal interpretation. He urged caution against being formalistic, to which he added that this would be his attitude toward many proposed rulings that would come before the Board. Generally speaking, he felt that lawyers could take either a formal or a liberal approach toward interpretation of the statutes, and in most cases he would favor the latter approach.

Chairman Martin commented that there was a difference between liberal interpretation of the law and rewriting of the law. In his judgment the Comptroller had rewritten the law frequently. The case before the Board was a difficult one, however, because it appeared that the Board, if it adopted the interpretation recommended by the Legal Division, would be standing on the letter rather than on the spirit of the law.

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Governor Daane commented that this was precisely the difficulty he found in the problem, following which Chairman Martin expressed the view that in any public discussion of the matter the Board, if it adopted the strict interpretation, would appear in a rather unfavorable light. Governor Daane said he had no question about the legal staff's being technically correct. He simply felt that it would be unfortunate to take a completely legalistic view on this particular matter and that a different position would come out right in terms of the spirit of the law.

Mr. Sanders noted that the Legal Division's memorandum attempted to point out that the obligations in question did not appear to meet the standards of the Comptroller's interpretation. The Comptroller's ruling stated, in effect, that in applying the 10 per cent limitation of section 5136 to bonds issued by the State Dormitory Authority such limitation could be applied separately to bonds issued for a particular college provided such bonds were repayable solely by that college.

After additional comments on procedures that apparently would be followed in event of failure by a particular college to turn over sufficient servicing revenue to the Authority, Governor Robertson observed that the Board had taken consistently the sound position that its job was to administer the law and not make the law. If the Board deviated from this principle, it might just as well adopt all of the changes in the law that had been made by the Comptroller. If the Board deviated in one case, it might as well deviate in all cases.

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Governor Daane indicated that he agreed with this statement as a matter of general principle. The Board was obliged to carry out the clear intent of the Congress as expressed in the statutes. But this was a case where he felt that the interpretation of the Comptroller was consistent with the spirit of the law, and therefore the question of rewriting the law was not involved. On the other hand, if the interpretation suggested by the Reserve Bank was inconsistent with the underlying purpose of the law, then he would feel that the Board must be bound by the statute.

Governor Robertson noted that the question involved was how to determine the purpose of the law. The word "obligor" had a clear meaning. The only way one could read into the statute something different would be to use one's own ideas as to whether or not the statute was sound.

Mr. Hackley made the comment at this point that when there had been doubt regarding the interpretation of a particular provision of the law the Legal Division had usually leaned toward a liberal interpretation. He cited certain examples. But in this case the issue turned on the meaning of the word "obligor," and there appeared to be no question on that score.

Chairman Martin said he thought it important to clarify the position of the Federal Reserve Bank of New York. This was the point that bothered him particularly. It was always difficult when lawyers disagreed concerning the law. Personally, he would like to make an interpretation along the liberal lines that had been mentioned. But if all the lawyers



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were clear that the statute could not be interpreted in such a way, that was another matter.

Chairman Martin therefore suggested making certain that there was not a difference of judgment on the legal issue. The Board, he thought, should be sure that the New York Bank and the Legal Division were in agreement. He would feel better if the Board's staff went back to the Reserve Bank and checked again.

The discussion concluded with an understanding that the Board's staff would discuss the matter further with the New York Reserve Bank.

All members of the staff except Messrs. Sherman, Kenyon, Young, and Sammons then withdrew from the meeting.

Technical assistance assignment. There had been distributed a memorandum from Mr. Young dated September 17, 1965, regarding alternative possibilities for meeting a request from the Central American Monetary Council for technical assistance in a study of consumer credit in the five Central American countries.

After discussion of these possibilities, it was the view of the Board that the assignment of Yves Maroni, Senior Economist in the Division of International Finance, would offer the best solution. Accordingly, it was agreed unanimously that Mr. Maroni's services would be offered to the Central American Monetary Council for the purpose requested, it being contemplated that the assignment might extend over a period of perhaps four or five weeks, beginning in October, and that Mr. Maroni

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would continue on the Board's pay roll on a nonreimbursable basis with his transportation and per diem expense to be reimbursed by the Central American Monetary Council.

Outside business and teaching activities. Governor Shepardson referred to a distributed memorandum from the Division of Personnel Administration dated September 17, 1965, recommending that the Board grant permission to members of the staff who had reported outside business or teaching activities (as set forth in attachments to the memorandum) to enter into or continue the reported activities.

Governor Shepardson expressed his concurrence, and the recommendation was then approved unanimously.

Conference of Counsel. Governor Shepardson referred to a memorandum from Mr. Hackley, General Counsel, dated September 20, 1965, recommending that the Board authorize the holding of a conference of Federal Reserve Counsel on October 18 and 19, 1965, along with a dinner on October 18, provision for which had been made in the 1965 budget.

The recommendations were approved unanimously.

Budget review. Governor Shepardson referred to the President's request for cost reduction and management improvement in Government operations, in response to which the Board had assured the President of its concurrence in his objectives and its continuing interest in improving the efficiency and economy of its own operations. Governor Shepardson noted that the Board's budget for 1966 was in process of

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preparation by the respective divisions and offices. He stated that in the absence of objection he proposed to distribute a memorandum to division heads calling attention to the provisions of Budget Bureau Circular No. A-44 dated March 29, 1965, which described policies to be observed in agency cost reduction activities, and to request that in preparing his budget each division head submit a supplemental report giving the following information: (a) a list of obsolete or nonessential activities that had been eliminated in the new budget request and the resultant savings in personnel or other costs; (b) proposed changes in procedures to improve manpower utilization and the resultant savings in costs; (c) a list of additional activities or positions in order of ascending priority that could be eliminated if it were necessary to reduce the present budget 5 per cent in order to offset proposed increases, including the prospective increase in Federal salary structure, in the new budget.

After discussion, the Board endorsed the sending of the proposed memorandum by Governor Shepardson to the division heads.

The meeting then adjourned.

Secretary's Notes: On September 21, 1965, Governor Shepardson approved on behalf of the Board the following items:

Letter to Mr. George L. Stevens confirming arrangements for him to conduct a 24-hour course in Reading Improvement for members of the Board's staff as an activity of the Board's Employee Training and Development Program, a fee of \$40 to be paid for each participant in the course.

Memorandum from the Division of International Finance recommending an increase in the basic annual salary of James K. Nettles, Economist in that Division, from \$13,755 to \$14,660, effective September 26, 1965.

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Governor Shepardson today approved on behalf of the Board memoranda recommending the following actions relating to the Board's staff:

Appointments

Barbara Ann Kemp as Stenographer, Division of Personnel Administration, with basic annual salary at the rate of \$4,005, effective the date of entrance upon duty.


George William Smith as Laborer, Division of Administrative Services, with basic annual salary at the rate of \$3,385, effective the date of entrance upon duty.

Transfer

Gloria J. Ogden, from the position of Secretary in the Office of the Secretary to the position of Secretary in the Division of Research and Statistics, with an increase in basic annual salary from \$5,000 to \$5,505, effective September 26, 1965.

Permission to engage in outside activity

Harry E. Lynn, Draftsman, Division of Data Processing, to work for a local store on a part-time basis.

  
Secretary

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Item No. 1  
9/22/65

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



**ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD**

September 22, 1965

**Board of Directors,  
Mountain Trust Bank,  
Roanoke, Virginia.**

**Gentlemen:**

The Board of Governors of the Federal Reserve System approves the establishment by Mountain Trust Bank, Roanoke, Virginia, of a branch at 2820 Brambleton Avenue, S.W., Roanoke, Virginia, provided the branch is established within one year from the date of this letter.

**Very truly yours,**

(Signed) Elizabeth L. Carmichael

**Elizabeth L. Carmichael,  
Assistant Secretary.**

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)



**BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**

WASHINGTON, D. C. 20551

Item No. 2  
9/22/65

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

September 22, 1965



Board of Directors,  
Citizens Bank and Trust Company,  
Blackstone, Virginia.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Citizens Bank and Trust Company, Blackstone, Virginia, of a branch at the northwest corner of Main and Broad Streets in Blackstone, Virginia, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Elizabeth L. Carmichael

**Elizabeth L. Carmichael,  
Assistant Secretary.**

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)