

Minutes for December 20, 1965

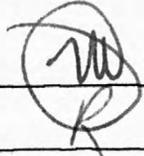
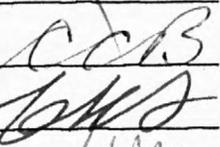
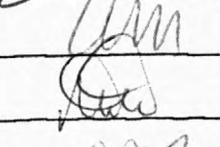
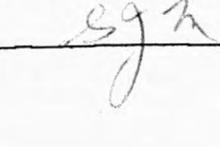
To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

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

Minutes of the Board of Governors of the Federal Reserve System
on Monday, December 20, 1965. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Holland, Adviser to the Board
Mr. Solomon, Adviser to the Board
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and
Statistics
Mr. Farrell, Director, Division of Bank
Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Associate General Counsel
Messrs. Shay and Hooff, Assistant General Counsel
Mr. Koch, Deputy Director, Division of Research
and Statistics
Mr. Partee, Associate Director, Division of
Research and Statistics
Mr. Dembitz, Associate Adviser, Division of
Research and Statistics
Mr. Leavitt, Assistant Director, Division of
Examinations
Mrs. Semia, Technical Assistant, Office of the
Secretary
Mr. Morgan, Staff Assistant, Board Members'
Offices
Mr. Heyde, Attorney, Legal Division
Mr. Eckert, Chief, Banking Section, Division
of Research and Statistics
Messrs. Egertson, Maguire, and McClintock,
Supervisory Review Examiners, Division of
Examinations

Circulated 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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	<u>Item No.</u>
Letter to Marine Midland Grace Trust Company of New York, New York, approving the establishment of a branch at East Bay Avenue and Whittier Street, Borough of The Bronx.	1
Letter to The Bank of Virginia, Richmond, Virginia, approving the establishment of branches at (1) Ridge Road, new extension of Parham Road, and the new location of Quioccasin Road, and (2) Parham Road and Broad Street Road (U.S. Route 250), both in Henrico County.	2

Application of Fidelity Bank. At the meeting on December 15, 1965, the Board discussed the application of Fidelity Bank, Beverly Hills, California, to merge South Bay Bank, Manhattan Beach, California. Certain questions were raised with respect to the condition of the applicant bank, including the amount of classified loans shown in the most recent report of examination, and also as to the qualifications of management. Action was deferred pending the obtaining of additional information.

There had now been distributed a memorandum dated December 20, 1965, in which the Division of Examinations reported supplemental information obtained by Chief Examiner Jamison of the Federal Reserve Bank of San Francisco during a visit to the applicant bank, at which time he reviewed the classified loans and met with several officers, all of whom were also directors. The facts reported indicated either current or prospective improvement in the areas of loan portfolio, liquidity, earnings, and management.

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Mr. Solomon commented on the supplemental information that had been submitted. There appeared to be progress in reducing the volume of classified loans, and management showed understanding of the bank's specialized real estate lending activities. Management proposed to hold the bank's loan-deposit ratio to no more than 65 per cent, which happened to be the average for all member banks in October 1965. After reviewing the supplemental information, the Examinations Department of the Federal Reserve Bank of San Francisco and the Board's Division of Examinations found somewhat firmer support for approval of the application and were inclined to have greater confidence in the ability of the applicant's management to deal with the bank's specialized operating situation.

In response to an inquiry, Mr. Solomon indicated that Mr. Jamison's report had been given in the form of a telephone conversation, supplemented by a telegram containing a progress report on the improvement in reducing classified assets.

Governor Daane remarked that even though Fidelity Bank did not seem to be in as questionable condition as had appeared earlier, it was not clear to him what positive grounds justified the merger. Mr. Solomon replied that some basis might be found in the convenience and needs factor and in the increased diversification of business. The latter point was especially important to Fidelity Bank because of its specialized type of operations. The merger would about double

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Fidelity's portfolio of consumer loans, thus providing some offset to the rather volatile type of business reflected in the bank's real estate loan activity.

After further discussion, Governor Robertson said that he would approve the application on the basis of the recommendation of the Federal Reserve Bank of San Francisco. He would tell the Reserve Bank, however, that the record raised a question whether Fidelity Bank was sufficiently free from problems to warrant its expansion through merger, that approval was being given on the strength of the Reserve Bank's recommendation, and consequently that special supervisory care should be exercised.

Governor Shepardson noted that Governor Robertson appeared to contemplate that such comments would be included in a letter to the Reserve Bank rather than in the published statement concerning the merger application. He then inquired whether it would not be desirable to have the Reserve Bank put in writing what had been reported in Mr. Jamison's telephone conversation.

Governor Robertson agreed that it would seem appropriate to have a written statement from the Reserve Bank for the record.

Mr. Shay referred to the statutory requirement that the basis for approval of each merger be published in the Board's Annual Report, and to the fact that the Board had been in the custom of describing the basis for approval in its statements on merger applications.

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During an ensuing discussion of the point raised by Mr. Shay, comment was made that the ultimate responsibility for approval of a merger rested with the Board, regardless of what reliance was placed on the findings of the Reserve Bank concerned. It was noted that the statement issued in this case could indicate that the Board had had regard for such matters as the applicant bank's proposals to improve its capital position and to effect operating economies.

Governor Robertson stated that he wished to make it clear that he regarded the total record of this case as including the report received at this meeting, the purport of which was that the problems in regard to the applicant bank were not so significant as would appear from the original record. He would like to make the Reserve Bank aware that the record was being read in that light.

Governor Shepardson said that he agreed essentially with Governor Robertson's views. Although Mr. Shay had raised an appropriate question, it seemed to him that it would be in order to indicate in the letter to the Reserve Bank that while the Board had approved the merger, it would expect the Reserve Bank to keep in close touch with the progress made by the applicant bank.

Governor Mitchell commented that to him the corporate interest was primarily involved in this case, that is, the benefit that the stockholders of the two banks would gain from the merger. On that ground he would approve, since the public interest would not appear to be offended by the transaction.

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Governor Daane remarked that although there were aspects of the case he disliked, on balance he would approve, with the expectation that the caveats outlined by Governor Robertson would be included in the letter to the Federal Reserve Bank of San Francisco.

Governors Maisel and Balderston also indicated that they would approve.

The application of Fidelity Bank to merge South Bay Bank was thereupon approved unanimously. It was understood that an order and statement reflecting this decision would be prepared for the Board's consideration, along with a letter to the San Francisco Reserve Bank.

Appointment of director. Inquiries regarding two persons who had been suggested for appointment to fill a vacancy in the directorate of the Baltimore Branch of the Federal Reserve Bank of Richmond had disclosed that they were not available to serve in such capacity. The Board therefore agreed that it should be ascertained through the Chairman of the Richmond Reserve Bank whether Arnold J. Kleff, Jr., Manager, American Smelting & Refining Company, Baltimore, Maryland, would accept appointment, if tendered, as a director of the Baltimore Branch for the unexpired portion of the term ending December 31, 1966, with the understanding that if it were found that he would accept, the appointment would be made.

Secretary's Note: It having been ascertained that Mr. Kleff would accept the appointment, if tendered, an appointment telegram was sent to him on December 22, 1965.

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Messrs. Shay, Morgan, Heyde, Egertson, Maguire, and McClintock then withdrew from the meeting.

Proposals relating to Regulations Q and D. On several occasions, most recently on December 17, 1965, the Board had discussed various proposals for amendments to Regulation Q, Payment of Interest on Deposits, and Regulation D, Reserves of Member Banks. Subsequent to the discussion on December 17, there had been distributed a memorandum of the same date with which Mr. Hackley submitted draft notices of proposed rule making, for possible publication in the Federal Register, regarding (1) amendments to Regulations Q and D to cover promissory notes of member banks, (2) an amendment to Regulation Q to eliminate the provision for payment of a time deposit before maturity "in emergencies," and (3) a draft alternative amendment with regard to the payment of time deposits before maturity; the alternative would permit payment before maturity if the depositor forfeited all accrued interest on the amount withdrawn.

At the beginning of today's discussion Mr. Hackley suggested that it might be helpful to review briefly the various proposals the Board had been considering, not all of which had the same purposes. On December 17 the Board had requested the preparation of drafts that would implement two proposals--first, to bring promissory notes within the definition of deposits in Regulations Q and D, and second, to restrict payment of time deposits before maturity. An alternative to the latter

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proposal would be to permit payment before maturity but with forfeiture of interest on the amount withdrawn, which meant that in some cases a deduction from principal might be required if the bank had previously paid any interest. During other recent discussions the Board had also considered a proposal to redefine time deposits in Regulations Q and D so as to limit them to deposits having a single specified maturity, with no provision for automatic renewal, and a proposal for graduated reserve requirements on demand deposits. On December 17 Governor Robertson had suggested a further proposal with respect to reserve requirements, namely, that on time deposits on which a bank by contract agreed to pay a rate of interest greater than 4 per cent there be prescribed a higher reserve requirement than against time deposits bearing a rate no higher than the 4 per cent permissible for savings deposits.

According to Mr. Hackley's understanding, an objective of some of the proposed amendments was to prevent or retard an undue shift of savings funds to commercial banks from savings and loan associations. A related objective was to discourage the spread of issuance of so-called savings certificates or savings bonds, which in effect could be used to take the place of regular savings deposits. He did not believe, for reasons which he outlined, that the proposals for restricting payment of time deposits before maturity would have a great deal of effect in retarding a shifting of funds from savings and loan associations.

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The imposition of a higher reserve requirement on time deposits could have some deterrent effect; it could make banks more reluctant to issue savings certificates on a wholesale scale in lieu of accepting regular savings deposits.

Governor Maisel referred to a provision of the draft amendment that would prohibit the payment of a time deposit before maturity. This provision would indicate that a member bank (as at present) could make a loan to a depositor upon the security of his time deposit provided the rate of interest on the loan was not less than 2 per cent per annum in excess of the rate of interest on the time deposit. He said he had had the impression that the discussion on December 17 also dealt with the inclusion in Regulation Q of a statement on usury.

Mr. Hackley responded that that possibility had been considered. However, since an interpretation on this subject had been published in the Federal Reserve Bulletin in April of this year, it was felt that if any question of that kind should be raised the answer lay in the published statement or a further interpretation. The April interpretation indicated that if State law fixed 6 per cent as the maximum rate of interest on loans and a member bank was paying 4.5 per cent on a time deposit, the bank (pursuant to section 217.4(e) of Regulation Q) could not make a loan on the security of the time deposit unless it charged 6.5 per cent, which would violate State law; however, the bank

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and its depositor by agreement could reduce the rate of interest paid on the deposit from 4.5 to 4 per cent, whereupon the bank could make a loan on the time deposit at 6 per cent. The Legal Division felt that such an interpretation might be too complex for inclusion in a footnote in the regulation.

Governor Maisel then asked about the period of interest that it was contemplated would be lost under the alternative draft of amendment permitting payment of time deposits before maturity only with forfeiture of interest.

Mr. Hackley said the Legal Division had had in mind forfeiture of all interest from the date of deposit. Forfeiture of interest only from, say, the previous quarterly interest payment date would not be a very great deterrent to withdrawal.

Governor Mitchell expressed the view at this point that since the Board was taking steps to obtain information regarding the use being made by banks of their increased interest-rate latitude, it would be inadvisable to take any action on time deposits at the present time.

Governor Maisel believed the Board should have a staff study of the objectives of the proposed amendments and their implications for the credit structure of the country.

Governor Balderston then requested that, in order to focus the discussion, Mr. Hackley divide according to their objectives the five proposals he had mentioned.

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Mr. Hackley expressed the view that the promissory note measure should be considered by itself, since it did not appear to have the same objectives as the other proposals. Several of the other proposals were apparently directed primarily at meeting the complaints of the savings and loan industry by retarding an undue shift of funds from savings and loan associations to banks, or at discouraging an untoward shift of funds from savings accounts in banks to technical time deposits. A third category would be the proposal for establishing graduated reserve requirements on demand deposits.

Accordingly, Governor Balderston suggested that the Board dispose of the promissory notes matter first.

The discussion that followed included suggestions for phraseology of the explanatory statement that would be published with the draft amendment in the Federal Register and consideration of the question when promissory notes issued by banks would become subject to the provisions of the amendment, if it was finally adopted.

All members of the Board except Governor Maisel then indicated that they would favor sending the proposed amendment to the Federal Register to be published for comment. Governor Maisel said that he did not believe promissory notes were being issued for the purpose of evading the requirements of Regulation Q. He thought they were a form of debt different from a deposit and were therefore not properly to be considered as an evasive device.

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The discussion turned to the timing of publication and it was brought out that there was a question as to the extent to which, and in what terms, the actions being considered by the Board should be made known by Governor Balderston at a committee meeting he was to attend this afternoon. (The committee was a variant, through temporary expansion to include representation of the Treasury Department proper, of the interagency Coordinating Committee in the bank supervisory area.)

Governor Balderston observed that the committee already knew that the Board had communicated with member banks to seek information on the extent to which banks were availing themselves of the increased latitude provided by the recent increase in the maximum rate of interest payable on time deposits. He asked if it would not be in order for him to report to the committee that the Board was about to publish in the Federal Register the draft of amendment affecting promissory notes. He might inform the committee also that the Board was studying a revision of the definition of time deposits to distinguish more clearly between passbook savings deposits and time deposits, but that a conclusion would be deferred pending the results of the current survey of changes in time and savings deposit rates.

In a discussion of various considerations bearing upon the question presented by Governor Balderston, Governor Mitchell remarked that it would not be desirable to place the Board in the position of

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seeming to say that it wanted to blunt the competitiveness of the banking system, if that competitiveness was soundly based.

Governor Balderston commented that Chairman Randall of the Federal Deposit Insurance Corporation had expressed concern as to possible imprudence on the part of banks. He (Governor Balderston) had responded that the Board was equally concerned about imprudent banking. The request for information as to current changes in bank interest rate practices was an effort to explore the question of possible imprudence.

Governor Shepardson observed that if the concern of the Federal Deposit Insurance Corporation related principally to small banks, it might be noted that most of such banks were outside the System and would not be affected by changes in Federal Reserve regulations.

Governor Daane said that, the promissory notes matter having been disposed of, he shared Governor Mitchell's view that the Board should defer action on the other proposals until the information that had been requested could be studied. He (Governor Daane) did not feel that it would be appropriate to tinker with reserve requirements at the present moment, and did not think it would be particularly fruitful to discuss possible changes.

Governor Maisel said that he had thought a part of the Board's concern centered on the question whether the issuance of negotiable

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certificates of deposit had introduced an unstable element into the monetary system. He believed the Board ought to have a rather careful statement from the staff on the implications for the monetary system of the different steps being considered. Governor Mitchell joined in the request that the staff prepare a paper specifically addressed to the question of stability.

After further discussion Governor Robertson said that, since it was obvious the Board would not take action today, other than on the promissory notes, he would like to have from the staff a memorandum covering four items. His basic premise was that the Board had made a mistake in attempting to differentiate between savings deposits and time certificates insofar as ceiling rates of interest were concerned. However, he thought the Board should be in the best position possible to justify its action and present some rational basis for so differentiating. When the survey information currently being solicited was received and analyzed, he hoped the Board would consider prompt action on these four items as a package: (1) to limit time certificates to a specified maturity with no automatic renewal, as suggested in one alternative of Mr. Hackley's memorandum of December 9, 1965; (2) to prohibit the payment of any time certificate before maturity, other than in emergency cases, except with a forfeiture of all interest for some specified period as a penalty for early withdrawal; (3) to increase from 4 to 5 per cent the reserve requirement

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on time certificates of deposit on which a rate of interest of more than 4 per cent was paid; (4) to adopt a graduated scale of reserve requirements as follows: for the first \$2 million of demand deposits, 7 per cent; up to \$125 million, 12 per cent; and over \$125 million, 17.5 per cent. He would also like to have an analysis of the result if a 10 per cent requirement were used from \$2 million to \$75 million and a 12.5 per cent requirement from \$75 million to \$200 million or some higher figure. This would provide four steps instead of three in the graduated scale.

Governor Mitchell commented that he too would like to see a system of graduated reserve requirements adopted, based on firm recommendations from the staff, but there were an infinite number of plans that could be devised. Accordingly, he thought it was necessary to give the staff some guidelines. It seemed to him, as one guideline, that a requirement of 7 per cent should be provided for some group of banks. It would seem necessary also to say something about the total amount of reserves to be released, and something about the maximum requirement. He would not object to the maximum of 17.5 per cent that Governor Robertson had suggested, although he would prefer 17 per cent.

In response to a staff inquiry as to how important it would be to minimize the number of banks that would have increases in their reserve requirements, Governor Robertson observed that the plan to

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which he had referred reduced the incidence as low as any plan he had seen.

Governor Maisel expressed the view that the Board should really be asking the staff about the advantages and disadvantages in the use by banks of different types of techniques for the attraction of savings, and for a judgment on the liquidity considerations involved.

Governor Robertson replied that, although he recognized the desirability of proceeding from the general to the specific, he would not want the specific excluded.

Governor Shepardson said that he thought a first step should be to evaluate the information resulting from the current survey, and then to await the staff studies that had been suggested. Today's discussion would not seem to point to any specific action at this time.

Governor Balderston remarked that hearings might be held early in 1966 at the behest of the savings and loan industry. Under normal conditions he would favor Governor Robertson's suggestion that the Board develop a package, but the period ahead might not be normal. Accordingly, it might be prudent to move forward most promptly on Governor Robertson's first two items, so that the Board could be prepared to act when the information came in from the current survey. An immediate problem was whether to inform the interagency committee this afternoon that the Board was studying a number of actions that might be taken after the facts were at hand.

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Governor Robertson suggested informing the committee that the Board was considering various proposals but had not yet come to conclusions. However, Governor Mitchell expressed the view that it would be unwise to reveal at this time anything other than the move the Board proposed to announce (on promissory notes). The needs of the interagency committee could be served adequately by saying that when the survey information was available the Board would tell the committee what action, if any, was in prospect. Governor Daane agreed.

Question again was raised as to what would be the Board's intent on making the provisions of the promissory note amendment effective if it should be finally adopted. One suggestion was that an announcement by the Board at the time of sending the proposed amendment to the Federal Register for publication for comment indicate that the provisions of the amendment would apply to all funds received from the sale of promissory notes after the date of such announcement. Another suggestion was that the provisions of the amendment be made applicable only to funds received beginning with the effective date of the amendment. It was left that the question would be studied further by the staff, and it was understood that Governor Balderston would not refer to this particular question in his remarks to the interagency committee this afternoon.

The meeting then adjourned.

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

Appointment

Mary Jenkins as Cafeteria Helper, Division of Administrative Services, with basic annual salary at the rate of \$3,507, effective the date of entrance upon duty.

Transfer

Gordon B. Grimwood, from the position of Chief, Liaison Office, Office of Defense Planning, to the position of Assistant to the Director, Division of International Finance, with no change in basic annual salary at the rate of \$18,825, effective January 2, 1966.

Salary increase

Mercy M. Heath, Statistical Clerk, Division of Research and Statistics, from \$4,429 to \$4,797 per annum, effective January 2, 1966.

Meritorious salary increases, effective January 2, 1966

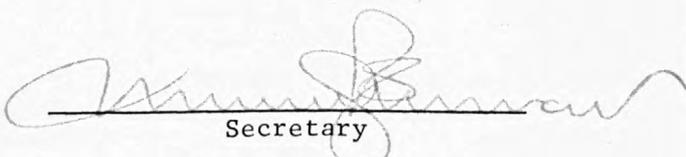
<u>Name and title</u>	<u>Division</u>	<u>Basic annual salary</u>	
		<u>From</u>	<u>To</u>
<u>Office of the Secretary</u>			
Marjorie Eaton, General Assistant		\$ 8,495	\$ 8,749
Ruth W. Franta, Supervisor, Minutes Indexing and Reference Unit		7,718	7,925
Margaret J. Molster, Supervisor, Subject Files		7,511	7,718
<u>Research and Statistics</u>			
Peter M. Keir, Chief, Capital Markets Section		19,415	20,005
Bernard N. Freedman, Economist		14,685	15,120
Normand R. V. Bernard, Economist		13,815	14,250
Elizabeth B. Sette, Chief, Economic Editing		13,815	14,250
Edward R. Fry, Economist		12,945	13,380
Franklin V. Walker, Economist		12,945	13,380
Milo O. Peterson, Economist		11,723	12,091
Virginia Ann Callahan, Secretary		5,523	5,694

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Meritorious salary increases (continued)

<u>Name and title</u>	<u>Division</u>	<u>Basic annual salary</u>	
		<u>From</u>	<u>To</u>
<u>International Finance</u>			
Gordon B. Grimwood, Chief, Liaison Office, Office of Defense Planning ^{1/}		\$18,825	\$19,415
Rosemary A. Darlington, Economist		7,479	7,733
John A. Marlin, Economist		7,733	7,987
<u>Bank Operations</u>			
Mary Frances Gifford, Statistical Assistant		6,036	6,207
<u>Examinations</u>			
Allen F. Goodfellow, Review Examiner		13,380	13,815
Kendall R. Free, Digital Computer Programmer		5,702	5,894
<u>Personnel Administration</u>			
Glenn L. Hogle, Personnel Technician		7,479	7,733
<u>Administrative Services</u>			
Lola Buckley, Telephone Operator		5,269	5,409
Lovair Dingle, Messenger-Driver		3,507	3,626
<u>Office of the Controller</u>			
Joseph H. Hoyle, Supervisor, Payroll and Disbursing		7,925	8,132
<u>Data Processing</u>			
Darrell Pepper, Chart Machine Operator		5,352	5,523
Lyla E. Szillat, Digital Computer Systems Operator		6,207	6,378
Kathryn A. Jackson, Statistical Assistant		6,662	6,854



Secretary

^{1/} Title, effective January 2, 1966, Assistant to the Director,
Division of International Finance.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

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Item No. 1
12/20/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 20, 1965

Board of Directors,
Marine Midland Grace Trust Company
of New York,
New York, New York.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Marine Midland Grace Trust Company of New York, New York, New York, of a branch at the southeast corner of the intersection of East Bay Avenue and Whittier Street, Borough of The Bronx, New York, New York, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
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
12/20/65

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 20, 1965

Board of Directors,
The Bank of Virginia,
Richmond, Virginia.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by The Bank of Virginia, Richmond, Virginia, of two branches in Henrico County, Virginia; one at the intersection of Ridge Road, new extension of Parham Road, and the new location of Quioccasin Road, and the other at the intersection of Parham Road and Broad Street Road (U.S. Route 250), provided the branches are established within one year from the date of this letter.

It is the Board's understanding that consideration is being given to means to strengthen your bank's somewhat less than satisfactory capital position.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
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 branches; 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.)