The attached minutes covering the meeting of the Board of Governors with the Presidents of the Federal Reserve Banks on January 11, 1966, which you have previously initialed, have been revised in certain respects, as indicated in the attached memorandum of changes, in the light of suggestions received from the Reserve Banks.

If you approve the minutes as revised, please initial below:

Chm. Martin ______

Gov. Robertson ______

Gov. Balderston ______

Gov. Shepardson ______

Gov. Daane ______

Gov. Maisel ______

CONFIDENTIAL (F.R.)

Memorandum of changes in the minutes of the meeting of the Board of Governors with the Presidents of the Federal Reserve Banks held on January 11, 1966.

(Deletions are shown by canceled type and additions by capital letters.)

Page 3, last complete sentence:

His [Mr. Holmes'] concern stemmed from the magnitude of the adjustment rather than from any question about the desirability in principle of defining promissory notes AND CERTAIN OTHER BANK LIABILITIES as deposits.

Page 7, first full paragraph:

President Ellis said that ~~he-had-some-sympathy-with-the-approach of~~ IN CHOOSING BETWEEN A COMPREHENSIVE REDEFINITION OF DEPOSITS VERSUS ACTING ONLY ON PROMISSORY NOTES WE SHOULD ANTICIPATE THAT THE COMPREHENSIVE APPROACH WOULD INVOLVE THE SYSTEM IN SUCCESSIVE ACTIONS TO block~~ing~~ one ~~avenue~~ LOOPHOLE after another. ~~However,-there-was~~ HE RAISED the question OF whether the Federal Reserve wanted to embark on a course that was going to lead it in this direction.

Page 16, first incomplete paragraph, next to last sentence:

It was too early to tell whether there was danger, in terms of the national economy, of a significant loss of funds by savings banks and savings and loan associations. ~~They~~ A NUMBER OF SAVINGS BANKS were the first, he [President Hayes] noted, to start raising rates after the Federal Reserve action.

Page 18, last incomplete paragraph, first, second, and fourth sentences:

President Swan noted that the banks in the Twelfth District had RELATIVELY more time and savings deposits than those in ~~any~~ other areaS. Even so, he did not ~~find~~ BELIEVE that ~~too-much~~ WHAT had happened TO RATES AND TERMS in the District CALLED FOR CHANGES IN REGULATION Q AT THIS TIME. . . . . The saver should share in the increased rates that banks were obtaining, and he thought it was ~~too-early~~ NOT NECESSARY to attempt to "save people from themselves" if they invested in savings certificates that had various conditions attached.

Page 22, second paragraph, first sentence:

President Hayes said he AND HIS ASSOCIATES had talked informally with all of the large banks in the New York area and had attempted to follow the general pattern of discussion suggested in the Board's letter of December 23, 1965.

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Minutes for January 11, 1966.

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. 1/

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	WM
Gov. Robertson	R
Gov. Balderston	CCB
Gov. Shepardson	CNS
Gov. Mitchell	GM
Gov. Daane	[illegible]
Gov. Maisel	SJM

1/ Meeting with Presidents of the Federal Reserve Banks.

A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held in the Board Room of the Federal Reserve Building on Tuesday, January 11, 1966, at 2:00 p.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Young, Senior Adviser to the Board and Director, Division of International Finance
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. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Koch, Deputy Director, Division of Research and Statistics
Mr. Partee, Associate Director, Division of Research and Statistics
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Eckert, Chief, Banking Section, Division of Research and Statistics

Messrs. Ellis, Hayes, Bopp, Hickman, Patterson, Scanlon, Shuford, Galusha, Clay, Irons, and Swan, Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco, respectively

Mr. Heflin, First Vice President, Federal Reserve Bank of Richmond

Messrs. Holmes, Eastburn, Mann, Baughman, Jones, and Tow, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Chicago, St. Louis, and Kansas City, respectively

Export-Import Bank certificates. Mr. Hackley outlined a question, raised by the Export-Import Bank, as to whether participation certificates representing interests in loans by such bank could be regarded as eligible for purchase by Federal Reserve Banks under section 14(b) of the Federal Reserve Act and, accordingly, eligible as collateral for advances to member banks under the eighth paragraph of section 13. After discussion, it was understood that any comments by Reserve Banks on this matter would be forwarded to the Board for its assistance in consideration of the question.

Promissory notes. On December 23, 1965, there had been sent to the Federal Reserve Bank Presidents a draft notice of proposed rule making involving an amendment to Regulation Q, Payment of Interest on Deposits, (and also Regulation D, Reserves of Member Banks), that would define the term "deposit" to mean any indebtedness of a member bank arising 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 was not reflected on the books or reports of the debtor as a deposit or of the creditor as a cash balance, and (3) indebtedness subordinated to the claims of depositors and general creditors. In preparation for this meeting there had also been distributed copies of a letter from the New York Reserve Bank dated December 31, 1965, commenting on the proposed amendment, and a memorandum from Mr. Holland dated January 7, 1966, discussing various types of money market transactions that would be affected by the proposal.

Asked by Chairman Martin for his views regarding the impact of such a move on the market, the Manager of the System Open Market Account (Mr. Holmes) noted that the proposal, as drafted, would affect not only promissory notes but repurchase agreements. The problem, then, related to the magnitude of the adjustments that the money market banks would have to undertake. In effect, the proposal would rule out the payment of interest by banks on any debt owed to nonbank sources with a maturity of less than 30 days. While good statistics were not available, his best estimate was that there might be $2 billion or more of debt that banks would have to refinance on a basis longer than 30 days or replace in some other way, at a time when money market banks were already under unusual pressure. Aside from psychological considerations, the necessity to make an adjustment of this magnitude would place a substantial burden on the banks. In terms of repercussions in the money market, it could create further upward pressure on certificate of deposit and other rates. His concern stemmed from the magnitude of the adjustment rather than from any question about the desirability in principle of defining promissory notes and certain other bank liabilities as deposits. A statement at the time of publication of the proposal for comment that the amendment, if adopted, would not become effective for a period of 60 or 90 days would take away some of the sting, but there would still be a major adjustment problem for some banks in addition to the adverse psychological reaction resulting from publication of the notice. Some banks depended heavily on borrowings in the form of repurchase agreements to finance large basic deficit positions. If the proposal were confined to promissory notes, the impact would be less severe. The promissory note was a newer instrument; its use was not such an ingrown part of market practices.

President Hayes commented that about a year ago, when the New York Reserve Bank proposed a reclassification of short-term promissory notes as deposits, it had in mind, mainly because of market aspects, dealing with this part of the problem and not getting heavily involved with the other. He had considerable sympathy with the view that repurchase agreements and other transactions of like character were somewhat akin to promissory notes, and it might be that they should be dealt with at some juncture. In its December 31 letter, he recalled, the New York Bank had suggested that because of market implications it might be better to defer publication of a notice of proposed rule making for a month or so. If it was felt strongly, however, that some kind of action was needed immediately, he would prefer to deal only with promissory notes at this juncture. Such action would take care of a problem that he had looked upon with trepidation, that is, the spread of the issuance of promissory notes. Such notes were clearly a substitute for certificates of deposit, and they were used to a large extent for the same purpose, whereas the other types of transactions were not. In terms of magnitudes, the total of short-term notes outstanding appeared to be around \$1/2 billion, a much smaller figure than the $2 billion Mr. Holmes had mentioned, so a proposal covering promissory notes only would have a less disturbing effect on the market. This was a practical way of looking at the matter.

President Hickman stated that certain large banks in the Fourth District were presently contemplating the issuance of unsecured notes. This involved a subterfuge to avoid the regulations applicable to deposits, and he felt that it would be well to move fairly promptly to deal with the practice. The repurchase agreements, on the other hand, served a useful purpose in the money market.

President Shuford noted that in Tennessee there was a State statute limiting to 4 per cent the rate of interest that could be paid by banks on deposits. Some large banks in Memphis had issued notes as a means of competing for CD money with institutions in other centers. He was not unsympathetic with the proposal to define promissory notes as deposits, and he recognized that it was not practicable to take into account the laws of every State, but a practical problem would appear to be involved for banks in some States. President Patterson observed that the same question was presented from the standpoint of Sixth District banks located in Nashville.

Chairman Martin asked Mr. Hackley whether it would be logical to move on the promissory notes only, and the latter replied that logically it would seem difficult to justify excluding repurchase agreements if they and the notes were simply different instruments that accomplished substantially the same purpose. President Hickman commented that in practice they were used for different purposes, and President Swan said he thought there was a fairly fundamental difference. Use of the notes was open ended, whereas the use of repurchase agreements was limited by the amount of securities available to a bank at a particular time.

As the discussion proceeded it was pointed out that a number of national banks appeared to have already received the draft notice of proposed rule making, copies apparently having been sent to them by the Comptroller of the Currency.

President Ellis turned to the question of subordinated versus unsubordinated notes, the first of which would not be covered by the proposal. He understood that when promissory notes were first issued there was a question whether they would be subordinated or not, and for the large banks, at least, there was a suggestion that this did not make too much difference. The question was whether the proposal would accomplish much if banks could still issue subordinated notes that would not be classified as deposits.

Governor Robertson stated that a basic consideration was to distinguish between debt and capital. Use by banks of notes to obtain long-term funds for capital purposes was not at issue here. Some thought had been given to excluding subordinated notes with a maturity of five years or more. Then it was decided to watch market developments and see whether it became necessary to distinguish between subordinated and unsubordinated notes.

President Ellis said that in choosing between a comprehensive redefinition of deposits versus acting only on promissory notes we should anticipate that the comprehensive approach would involve the System in successive actions to block one loophole after another. He raised the question of whether the Federal Reserve wanted to embark on a course that was going to lead it in this direction.

Governor Mitchell commented that the problem involved forcing the banks to report promissory notes as either deposits or borrowings, the Comptroller having ruled in effect that they were neither. If they were to be classified as deposits, that led to the problem of repurchase agreements. This might not be a good time to go that far. However, the movement toward the issuance of notes appeared to be spreading so rapidly that it would become increasingly difficult to take action if the Board did not act now.

President Hayes suggested the possibility of proposing an action limited to the notes and at the same time stating that the System planned to study the field further and that at some time in the future there might be an extension to other instruments of the principle being applied to promissory notes.

Mr. Holmes commented that the market had been on notice for some time that promissory notes might at some stage be classified as deposits. The volume of such notes outstanding was not so large as to create an unmanageable problem. If the publication of a notice of proposed rule making limited to promissory notes included an indication of the likelihood of further study of instruments similar to the notes, there might be some market impact, but not as much as would be created by a more far-reaching notice of proposed rule making.

President Galusha observed that whenever regulatory agencies moved to correct a situation, lawyers representing affected clients customarily endeavored to find means of offsetting the action taken. He had a feeling that perhaps the Board should think in terms of doing only, for the moment, what would hit at the most pressing problem. It would hardly be possible in one move to deal with all of the devices that might appear. But the Board could establish a climate of showing that it was aware of major abuses and was going to take steps as necessary.

There ensued discussion of the impact on banks with notes outstanding that had been issued on the assumption that the banks would not be required to maintain reserves against them, and several possibilities for alleviating this problem were mentioned. There was also discussion of the question whether the use of promissory notes was in fact spreading rapidly, particularly in view of the increased rate latitude available to banks for the sale of certificates of deposit. A further question that was considered related to the enforceability of a Board regulation as it applied to national banks.

Another question discussed was whether any longer-term unsubordinated notes had been issued by banks for capital purposes. The staff indicated there were no statistics available to show that such notes had been issued; however, it was possible that some may have been sold through private placements. A Board member noted that in any event banks would have 30 days in which to offer their comments following publication of a notice of proposed rule making.

Governor Robertson observed that if the proposed amendment was to cover only promissory notes, with an understanding that the Board would consider other instruments later, the Board should do its best to close as many loopholes as possible. On this basis the amendment might cover subordinated notes having a maturity of less than five years.

President Ellis commented that the important thing was to indicate that banks would be allowed to use subordinated notes for capital purposes. He would be loath to agree on any particular dividing point in terms of years until he had had a chance to study what banks had already done. He would opt for the minimum action that was clean to administer and would hit at the basic concern, namely, the use of promissory notes to avoid reserve requirements.

Governor Maisel said it was his feeling that the problem was not one of controlling the ways in which banks obtained money, but one of controlling deposits. One possible philosophy was that there should be reserves behind any instrument through which the banks obtained money. Another philosophy was to say what were really deposits and to make sure that banks kept reserves behind them. He favored the latter approach. It seemed to him repurchase agreements were clearly a different way of raising money, as were subordinated notes and possibly also unsubordinated promissory notes. Among these, he would be most inclined to agree that unsubordinated notes were deposits. In principle, however, he would prefer to leave the definition of deposits as narrow as possible and the definition of borrowings as wide as possible. The bringing in of subordinated notes and repurchase agreements as deposits would amount to proceeding on an assumption that deposits should be defined as widely as possible.

Governor Mitchell commented that logic called for distinguishing adequately between borrowings and deposits. If instruments were deposits, banks must maintain a reserve against them and the deposits must occupy a preferred position in terms of liquidation. If borrowing existed, it should be subordinated to the claims of depositors and general creditors.

There followed comments on how the proposed amendment might be reworded in light of suggestions that had emerged from today's discussion, and it was understood that the drafting problem would be given further consideration by the legal staff.

Chairman Martin then summarized the discussion by saying that the consensus apparently favored an amendment that would have the effect of covering only promissory notes. A period of 30 days would be allowed for the receipt of comments on the proposed amendment following its publication in the Federal Register. If the amendment was adopted an additional period would be allowed before it became effective in order to minimize the impact on the money market. A grandfather clause relating to outstanding notes might have as its cut-off point the date of the sending of the proposed amendment to the Federal Register. The notice in the Federal Register would contain an indication that study would continue concerning other borrowing instruments such as repurchase agreements.

Definition of time deposits. In preparation for this meeting there had been distributed a memorandum from the Board's staff dated January 7, 1966, relating that the recent increase in maximum rates of interest payable on time deposits under Regulation Q, Payment of Interest on Deposits, and the actions of banks in taking advantage of the enhanced flexibility had led to expressions of concern by spokesmen for competing savings institutions, by some bankers, by Congressmen, and by officials of other Government agencies. These expressions of concern focused particularly on the actions of banks to attract funds that would normally be savings deposits (or their equivalent at other institutions) through the issuance of savings certificates and bonds that qualified as time deposits and bore interest at rates considerably higher than the 4 per cent ceiling on regular savings deposits. The major question was whether and, if so how, the Board should amend Regulation Q to sharpen the distinction between savings and other time deposits, in particular to differentiate further the terms on which they could be redeemed. The memorandum discussed the areas of concern and issues involved, along with possible actions.

There had also been distributed a memorandum from Mr. Hackley dated January 6, 1966, submitting a draft of possible amendments to Regulation Q that would have the following effects: (1) time deposits would be redefined to exclude any deposit with more than one maturity or providing for automatic renewals for periods of less than 90 days; (2) any reduction by the Board in the maximum permissible rate of interest would be applicable to outstanding deposits with maturities of more than one year unless the Board at the time of such reduction expressly exempted outstanding deposits; (3) present provisions for payment of time deposits before maturity in hardship cases would be eliminated, but a depositor needing money would still be allowed to borrow from the bank on the security of his time deposit provided the rate of interest on the loan was not less than 2 per cent greater than the rate paid on the deposit. Another item that had been distributed was a memorandum from Mr. Hackley dated January 10, 1966, reflecting a suggestion by Governor Maisel under which a bank could agree to pay a time deposit before maturity, whether or not in emergency circumstances, provided the depositor paid a penalty of not less than one per cent of the amount withdrawn.

The participants in this meeting had also been furnished updated tabulations of commercial bank changes in rates and terms on time and savings deposits, as reported in response to the Federal Reserve's request for information in the latter part of December.

At the beginning of today's discussion, Governor Robertson made a statement in which he said the objective of the proposed amendments was to place the System in the best possible position to justify the distinction that had been made between savings deposits and other time deposits in terms of ceiling rates. As of now, the distinction was blurred by the use of savings certificates and bonds in lieu of savings accounts. Rates up to 5-1/2 per cent could be paid on such instruments, as contrasted with the ceiling of 4 per cent on savings accounts. Consequently, the thought was to sharpen the distinction between the two types of deposits. The Board's discussions had resulted in the possible amendments to Regulation Q reflected in the memoranda from Mr. Hackley.

President Hayes presented the view that action should not be predicated on the increase to 5-1/2 per cent in the ceiling rate on time deposits, other than savings deposits. The fact that the ceiling rate on savings accounts had not been raised in December did not mean that this rate should never be increased. With interest rates in general having moved up in the manner they had recently, it was quite conceivable that the ceiling on savings deposits might not remain at its present level forever. It seemed to him that the basic distinction between savings accounts and savings certificates lay in the fact that one was available to the depositor on demand, in effect, while the other involved putting money aside for some fixed period. Perhaps the distinction needed a little sharpening to provide an appropriate penalty if a savings certificate was redeemed before maturity, but in actual practice most of the certificates now carried such a penalty. The mere fact that individuals were showing interest in fixed maturity obligations did not suggest a need for any particular action. The public should have the option of choosing that kind of instrument in lieu of a savings account. Thus, the question was whether a need existed for complex additional provisions to justify a different ceiling rate on time deposits. He did not think this should be the main objective of the exercise. It made sense to clarify that there was some difference between a saving certificate and a savings account, but he questioned whether it was necessary to go as far as the amendments that had been suggested.

Governor Mitchell noted that there were basically four kinds of instruments involved: passbook savings accounts, which in effect were withdrawable on demand; negotiable certificates of deposit; non-negotiable certificates, or time deposits open account; and small denomination savings certificates. In view of the limitation of 4 per cent on passbook savings accounts, such accounts might be replaced substantially by certificates in small denominations. Many people would no doubt be sensitive to a significant interest rate differential. The Board had been wondering whether its position was viable as far as passbook savings were concerned. If the Board was ready to liberalize the ceiling on savings deposits, it would of course not have to concern itself so much about sharpening the distinction between savings and other time deposits.

Governor Daane expressed concern that a rate war might be in prospect that could have damaging consequences. There was some indication that many banks might even now be considering further increases in their rates on time deposits. One result could be a mismatching of assets and liabilities and an adverse impact on bank liquidity.

Governor Maisel suggested that the most useful comments that could be made on the matter went to the point of whether there was danger of a rate war and, if so, whether this would be damaging to the banking system. Another question was whether a rate war would have such an adverse effect on other savings institutions as to warrant real concern.

President Hickman described developments in the Fourth District and indicated that no real problem as yet appeared to exist in terms of undue escalation of rates. At the same time, demands for credit were converging on the banking system and moving away from the savings banks and savings and loan associations. In such circumstances, the theory in a free enterprise system was that funds should be allowed to flow to the commercial banks.

President Hayes agreed with the proposition of encouraging competition for savings funds and allowing them to be attracted to the banking system where credit demands were converging. Turning to the issues involved, as set forth in the staff memorandum of January 7, he felt it was in the public interest to encourage, or at least not to interfere with, the promotion of the new savings instruments by commercial banks, that the Board should not act to soften the competitive impact on other savings institutions, and that the Board should not take action on the theory of limiting a rate war that could lead some banks to overstretch their liquidity or asset soundness, because bank supervision should be relied upon to deal with any such dangers. He said his discussions with bank supervisory personnel disclosed no convincing evidence in the Second District of a damaging rate war and no reason to believe that the commercial banks could not afford to pay the rates they were offering. It was too early to tell whether there was danger, in terms of the national economy, of a significant loss of funds by savings banks and savings and loan associations. A number of savings banks were the first, he noted, to start raising rates after the Federal Reserve action. To date there was no evidence of a massive shift of funds that would jeopardize the mortgage market.

Governor Daane reverted to the question whether there was danger that the commercial banks would start competing among themselves through the payment of unduly high rates of interest, with resultant loss of liquidity through borrowing short and lending long.

President Hayes replied that his discussions with large banks boiled down to an expectation on their part that the demand for loans was going to stay high relative to normal seasonal patterns and that they felt obliged, therefore, to obtain money and pay whatever was necessary. Further, there were heavy CD maturities in the first quarter of this year that they must try to roll over. In this general atmosphere the rates being offered were not out of line with realities.

President Ellis questioned the relevance of the suggested amendments to the problem of a rate war. In the First District, he said, there had been some indication of situations developing where one bank would go as high as 5 per cent and competitors would follow, but such competitive actions would not appear to be controlled by the proposed sharpening of distinctions between time and savings accounts.

President Galusha commented that to the degree conditions fixed under Regulation Q became burdensome and started to exert a restraining influence on the banking system, the same problems would develop in the allocation of funds that were developing last fall. In the Ninth District, he continued, some country banks near the Twin City area probably were going to get hurt, but he suspected that many of them were getting hurt anyway--perhaps almost unawares--by fundamental changes that had been occurring in the communities and their resulting inability to compete effectively. There would be an additional burden on the bank supervisory agencies to watch the lines of credit being extended in such circumstances. But there was not too much that could be done about this kind of situation through the medium of Regulation Q action. If Regulation Q became too confining, counsel for banks would begin working to find ways around it.

President Hayes observed that for some time he and Chairman Martin had taken the position in Congressional testimony that Regulation Q should be placed on a standby basis in the absence of clear signs of abuses. He did not see such signs at present.

President Irons expressed general agreement with the foregoing views, saying that thus far he did not see evidence of a rate war or a panicky situation developing in the Eleventh District. Such a situation conceivably could develop quickly, but he did not find evidence of it at present. Banks had raised their rates to borrowers, apparently without difficulty, so they should not come out too badly if they had to pay higher rates for funds.

President Swan noted that the banks in the Twelfth District had relatively more time and savings deposits than those in other areas. Even so, he did not believe that what had happened to rates and terms in the District called for changes in Regulation Q at this time. The rates paid by savings and loan associations had traditionally been higher than those paid elsewhere throughout the country. The saver should share in the increased rates that banks were obtaining, and he thought it was not necessary to attempt to "save people from themselves" if they invested in savings certificates that had various conditions attached. A small difference between the rates advertised by savings and loan associations and those advertised by banks probably would not provoke a great many people to shift their funds, and in some cases savings and loan associations were known to offer certain unadvertised premiums if necessary to retain share accounts.

President Scanlon said his views were much like those of President Irons. He added that he would be more concerned about the possibility of banks taking on assets of poor quality in times when the demand for credit was not so vigorous as at present. He would not be too concerned about isolated cases where banks were offering high rates, particularly since it frequently developed that there were a number of conditions attached.

Governor Balderston commented that the discussion today reflected disagreement with the premise that there should be a more clear-cut distinction between savings deposits, which were closely related to demand deposits, and other time deposits. With the ceiling rate on other time deposits having been raised to 5-1/2 per cent, there had been some thinking within the Board that a need existed to distinguish more sharply and effectively. The Presidents, however, apparently would be content to say that it was appropriate for the ceiling on time deposits to be placed high enough to give the banks freedom of action. If so, the point of concern was how to prevent an undue lessening of liquidity, particularly among the smaller banks. The answer would appear to lie in the responsibility of the supervisory function to keep on top of the situation.

President Bopp commented by way of historical background that the legislation requiring interest rate ceilings to be prescribed for time and savings deposits grew only indirectly out of the competition for funds of the 1920's. Rather, it got its impetus from the bank failures in the early 1930's. He thought it was a fair assumption that there would not be a repetition of those circumstances except in a few isolated cases, so the problem now under discussion seemed to fall primarily in the bank supervisory area. He observed that at the present time an investor could obtain yields ranging up to 5 per cent on U.S. Government bonds, which must certainly be regarded as a safe investment.

President Hickman commented that from the cases he had studied he understood that many bank failures in the early 1930's were related to the fact that corporations abruptly withdrew large amounts of funds. This would suggest that the large blocks of CD money obtained from corporations constituted more of a problem than the small blocks of money obtained from individuals. One possibility might be a requirement prescribing a period, say 60 or 90 days, before funds represented by large certificates could be withdrawn, but the situation had not reached anything like the proportions that would call for such action.

President Bopp agreed with this analysis. He added that the small saver should have an opportunity to obtain the same rate on his funds as the large corporation.

President Hayes observed that the line between saving and investment was a fuzzy one. It could not be assumed that every savings depositor had an investment purpose, but such depositors were not oblivious to rate differentials. After referring to certain recent advertisements by savings banks on a rate basis, he repeated that the line between this kind of activity and certificate of deposit activity was becoming fuzzier all the time.

President Bopp expressed concern about the suggestion that had come from some sources outside the System for a regulation that would prohibit the issuance by banks of certificates of deposit below a certain amount. He saw no merit in such a suggestion. The individual should have an opportunity to obtain whatever type of instrument was made available to others.

Chairman Martin said he thought there was general agreement on that point, and there was also a question of legal authority. He turned to Mr. Hackley, who confirmed that the Board did not have authority to fix different maximum rates according to size of deposits. It might be argued that the Board could define time deposits to include only those over a certain amount, but even that might be legally questionable. In addition, the Board would be vulnerable on policy grounds if it appeared to discriminate against small depositors.

President Shuford expressed general agreement with the observation that it was too early to be sure about what would develop. In the Eighth District the situation as it had developed thus far could not be evaluated as anything approaching a rate war. He doubted whether any worthwhile purpose would be accomplished by a move at this time to differentiate more sharply between savings and other time deposits.

President Shuford also mentioned that certain large St. Louis banks had moved up their rates to 4-3/4 per cent or better on negotiable certificates of deposit, although they were still paying 3 per cent on savings deposits and apparently did not intend to move that rate up. He had some question whether anything would be gained by discussion with those banks, as contrasted with one small bank that had advertised rates indicating the possibility of lack of prudence. President Patterson said that similar circumstances prevailed in his area.

President Hayes said he and his associates had talked informally with all of the large banks in the New York area and had attempted to follow the general pattern of discussion suggested in the Board's letter of December 23, 1965. All of the banks knew quite well what they were doing. They foresaw continued heavy loan demand and believed they were justified in trying to cover it by paying higher rates on certificates of deposit.

President Galusha cited one bank in his area that had engaged in imprudent advertising and had benefited when certain problems involved in the advertising program were drawn to its attention.

President Clay inquired whether a Reserve Bank should exert an effort to obtain replies from all member banks to the questionnaire sent to them following Chairman Martin's telegram of December 17, and it was indicated that a reasonable effort would be in order.

The meeting then adjourned.

Secretary