

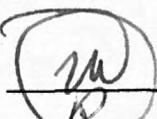
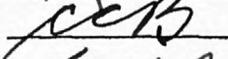
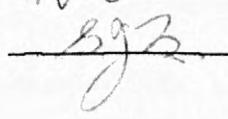
Minutes for January 20, 1966

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.

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 Thursday, January 20, 1966. 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. Mitchell
Mr. Daane
Mr. Maisel

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, 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. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and
Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Johnson, Director, Division of Personnel
Administration
Mr. Hexter, Associate General Counsel
Mr. Shay, Assistant General Counsel
Mr. Leavitt, Assistant Director, Division
of Examinations
Mr. Sprecher, Assistant Director, Division
of Personnel Administration
Mrs. Semia, Technical Assistant, Office of
the Secretary
Messrs. Heyde and Sanders of the Legal Division
Messrs. Smith and Wiles of the Division of
Research and Statistics
Messrs. Egertson and Maguire and Miss McShane
of the Division of Examinations

Request of United California Bank (Item No. 1). Unanimous
approval was given to a letter granting the request of United California

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Bank, Los Angeles, California, for an extension of time to establish a branch in Fresno. A copy is attached as Item No. 1.

Report on competitive factors. A report to the Comptroller of the Currency on the competitive factors involved in the proposed merger of Continental National Bank, Phoenix, Arizona, into The First Navajo National Bank, Holbrook, Arizona, was approved unanimously for transmittal to the Comptroller. The conclusion read as follows:

The proposed merger of Continental National Bank, Phoenix, into The First Navajo National Bank, Holbrook, would not have an adverse effect on competition.

Application of United California Bank. There had been distributed a memorandum dated January 17, 1966, with other pertinent papers, regarding the application of United California Bank, Los Angeles, California, to merge Security National Bank of Monterey County, Pacific Grove, California. The Division recommended approval, as had the Federal Reserve Bank of San Francisco.

After comments by Mr. Egertson, members of the Board asked a number of questions for informational purposes regarding matters such as the capital positions of the two banks, the reportedly impaired health of the President of Security National, earnings prospects of Security National in the light of start-up costs for several recently-opened branches, the premium being offered for the stock of Security National, and whether any effort had been made to sell to local interests or to a smaller bank than United California.

Governor Robertson said that he would disapprove. While he had sympathy for the President of Security National, who apparently was

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seeking a sale of the bank because of poor health, he did not believe the Board's approval should be based on such a circumstance. It would be his hope that if Security National must be sold it could be taken over by a smaller institution than United California that would provide competition for the large institutions, and he believed it should be possible to make such an arrangement. Such a sale might be less profitable than one to United California, but that was something he believed should not influence the Board's decision. He thought it was not incumbent on the Board to try to solve management problems in cases like this that involved merger with one of the largest banks in the State. Moreover, Security National had grown rapidly in recent years and apparently was rendering good service to its community, it was not in dire straits, and it was the only independent bank left in its area.

Governor Shepardson expressed the view that from the standpoint of service to the community there was nothing to be gained and perhaps something to be lost through the proposed transaction. However, assuming that the reports of the poor health of the President of Security National were correct, and since much of the bank's growth apparently had been the result of his activity, it seemed that a sale of the bank might be necessary. He was not sure it was realistic to think in terms of sale to a smaller institution; such a sale might not be at all easy to arrange. On close balance, he would approve.

Governor Mitchell stated that he too thought the balance was close, but he came out on the other side. Rather than see Security

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National merged into one of the large California banks, he would much prefer to see it continue with local support or be taken over by a relatively small bank with the same kind of competitive aspirations that Security National seemed to have. While the proposed merger might be the practical solution, he would disapprove.

Governor Daane also expressed regret concerning the elimination of an independent bank. However, the available evidence seemed to indicate that this was inevitable. Although he would like to see a solution such as Governor Mitchell had described, he doubted whether that kind of solution would be forthcoming. He came out on the side of approval, although without strong convictions.

Governor Maisel commented that the capital position of Security National seemed to be regarded as marginally adequate, and the bank did not appear to be in real difficulties. Although earnings had been adversely affected by the recent opening of several branches, this did not signify that the expectations that those branches would prove profitable in the future were not justified. The report that had been routinely requested from the Comptroller of the Currency dealt only with competitive factors, and to him it would make sense to ask the supervisor of the bank to be merged whether he regarded the bank's situation as unsatisfactory. He did not believe the Board should weigh the banking factors as conclusively supporting the merger without asking the opinion of the official who had been examining the bank. Lacking such an opinion, he would disapprove.

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Governor Balderston remarked that the Pacific Grove area was a fast-growing one that needed good banking service. Although he would have preferred to see a smaller institution than United California come into the area, he did not know whether it was realistic to deny the application in the hope that such arrangements could be made. Therefore, he would go along with the favorable recommendation of the Division.

Chairman Martin stated that he also would go along with the Division. It would be difficult to sift out the answers to all of the questions that had been raised, but the question of practical alternatives was a very real one. He had some doubt as to how much shopping around Security National could reasonably be expected to do to bring a smaller bank into the picture. It was regrettable to see an independent bank eliminated, but the difficulties involved in denial might be greater than those involved in approval, particularly in light of the realities of the California banking structure.

The application of United California Bank was thereupon approved, Governors Robertson, Mitchell, and Maisel dissenting. It was understood that an order and statement reflecting this decision would be drafted for the Board's consideration, and that a dissenting statement or statements would also be prepared.

Messrs. Shay, Heyde, Smith, Wiles, Egertson, and Maguire and Miss McShane then withdrew from the meeting.

Open Market Committee policy record. There had been distributed memoranda from Mr. Young dated October 15, 1965, and January 18, 1966,

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submitting, for publication in the Board's Annual Report for 1965, proposed entries covering policy actions of the Federal Open Market Committee during 1965, revised to take account of comments received from Committee members and staff following distribution of preliminary drafts. Also submitted was a prefatory statement similar in form to those included in the Annual Reports for the past several years. Mr. Young suggested that if the Board approved publication of the entries they be transmitted to the Reserve Bank Presidents for their information.

Governor Daane indicated that he had some question whether the language of the entry covering the meeting of the Committee on November 23, 1965, fully reflected the flavor of that meeting.

After further discussion the proposed entries were approved for inclusion in the Board's Annual Report, subject to the understanding that Governor Daane might submit suggestions for certain changes in the November 23 entry.

Proposed amendment on promissory notes (Items 2 and 3). The Board had had a series of discussions of possible amendments to Regulation Q, Payment of Interest on Deposits (conforming amendments would be made to Regulation D, Reserves of Member Banks). One such proposal would define the term "deposits" so as to include promissory notes issued by member banks and certain other forms of member bank indebtedness. That proposal, with certain others, had been discussed with the Reserve Bank Presidents on January 11, 1966. A revised draft had been sent to the

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Reserve Banks for comment on January 13, and the replies of the Reserve Banks were summarized in a distributed memorandum dated January 17 from the Legal Division. There had followed additional discussion at the Board meeting on January 18, and a further revised draft of notice of proposed rule making for publication in the Federal Register was subsequently distributed.

Mr. Hackley stated that the latest draft of proposed amendment included only one substantive change from the previous draft, namely, that the exemption for indebtedness subordinated to the claims of depositors and general creditors now specified an original maturity of more than two years rather than one year or more.

Governor Daane remarked that from discussion Mr. Holland had had yesterday with staff of the New York Reserve Bank it appeared that the change Mr. Hackley mentioned was agreeable to the Bank.

Mr. Holland confirmed this, and then commented on other aspects of his conversations with the New York Bank's staff. There was a recognized need for certain transactions that now took place in the form of Federal funds transfers between nonbank securities dealers and large money market banks. There were varying opinions within the Reserve Bank as to the effect of the proposed amendment in this regard, some staff members feeling that adjustments could be made within the money market without much difficulty, and others believing it would be necessary to seek a specific exemption. There had been general agreement with Governor Maisel's suggestion for contacting the dealers, upon publication of the

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rule-making notice, to solicit their comments on problems that might develop in their operations as a result of the proposed amendment.

Mr. Hackley then commented on the matter of timing, and the ensuing discussion disclosed general agreement that, with Federal Register publication probable on January 25, the deadline for submission of comments should be set 30 days later, or February 25, 1966; that if the amendment were then adopted its effective date should be deferred for an additional period of approximately 60 days to permit adjustments; that an announcement would be issued to the press at the time the notice of proposed rule making was sent to the Register; and that prior to such announcement the Reserve Bank Presidents would be informed by telegram.

The publication in the Federal Register of the notice of proposed rule making was thereupon authorized. A copy of the notice is attached as Item No. 2. A copy of the press release announcing this action is attached as Item No. 3. A telegram was sent to the Federal Reserve Bank Presidents, prior to the release of the press statement, quoting the text of the statement and of the notice of proposed rule making.

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

Retirement allowance of First Vice President. Among the matters that the Board had discussed with President Hickman of the Federal Reserve Bank of Cleveland on January 11, 1966, was a proposal by the Bank, as stated in a letter from Chairman Hall dated December 23, 1965, to supplement the retirement allowance of First Vice President Fink by something

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over \$1,000 annually through a lump-sum payment to the Retirement System of the Federal Reserve Banks. The additional payment would, in effect, give Mr. Fink retirement credit for the period of almost five years (prior to 1934) that he had worked at the Reserve Bank before attaining age 21. This would be an exception to the Rules and Regulations of the Retirement System that had not been granted to other officers or employees.

As a result of the discussion with the Board members on January 11, President Hickman had explored various alternatives and, with the knowledge of Chairman Hall, had sought informally the reaction of the Board to a proposal that Mr. Fink be retained on leave with pay for the period March 1-December 31, 1966.

At this meeting the two alternatives were considered by the Board, and it was the consensus that neither alternative would be desirable, the principal reason being that either of them would represent an exception, in an individual case, to generally applicable procedures. It was understood that this view on the part of the Board would be conveyed by the Secretary to President Hickman.

Some members of the Board suggested that further study be given by the Board's staff to the possibility of developing guidelines of general applicability that would increase the degree of flexibility available to the Reserve Banks in working out mutually satisfactory arrangements in cases where termination of the service of an officer or employee seemed desirable, for reasons of health or otherwise, at a

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time prior to normal retirement date. It was noted that the Retirement System currently contained provisions relating to disability retirement, special service retirement, and involuntary termination of service, and that any additional plan of early retirement might have to be set up outside the Retirement System.

Security clearance for Reserve Bank Chairman. Reference was made to a question that had come up through one of the Reserve Banks as to whether the practice should be followed of obtaining security clearance through full field investigation for the Chairman or Deputy Chairman of a Reserve Bank. It was the Board's view that such a procedure was not necessary, and it was understood that the Reserve Bank concerned would be informed to such effect.

The meeting then adjourned.

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

Appointment

Nathan L. Hunter as Messenger, Division of Administrative Services, with basic annual salary at the rate of \$3,507, effective the date of entrance upon duty.

Reemployment

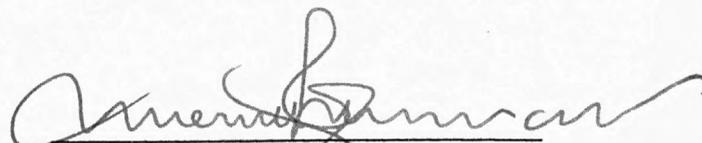
Phillip M. Wiggins, Messenger, Division of Administrative Services, with basic annual salary at the rate of \$3,507, effective January 20, 1966. (Military leave had previously been granted to Mr. Wiggins, but he had failed to pass the Armed Forces physical examination.)

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Permission to engage in outside activity

James L. Kichline, Economist, Division of Research and Statistics,
to teach two sections of a course in Principles of Economics at the
University of Maryland.



Secretary

Item No. 1
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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 20, 1966



Board of Directors,
United California Bank,
Los Angeles, California.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to August 5, 1966, the time within which United California Bank, Los Angeles, California, may establish a branch on or near Van Ness Avenue between Fresno Street and Tulare Street, Fresno, California.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

FEDERAL RESERVE SYSTEM

Item No. 2
1/20/66

[12 CFR Parts 204, 217]

[Regs. D, Q]

RESERVES OF MEMBER BANKS; PAYMENT OF INTEREST ON DEPOSITS

Notice of Proposed Rule Making

The Board of Governors is considering amending § 204.1 of Regulation D ("Reserves of Member Banks") and § 217.1 of Regulation Q ("Payment of Interest on Deposits") by inserting at the beginning of each the following new paragraph:

"(a) Deposit. - The term 'deposit' means any indebtedness of a member bank that arises out of a transaction in the ordinary course of its business with respect to either funds received or credit extended by the bank, except (1) indebtedness due to a Federal Reserve Bank, (2) indebtedness due to another bank for its own account that is not reflected on books or reports of the debtor as a deposit or of the creditor as a bank balance, (3) indebtedness arising from a transfer of direct obligations of the United States that the bank is obligated to repurchase, and (4) indebtedness subordinated to the claims of depositors and general creditors that has an original maturity of more than two years; Provided, however, That this paragraph shall not affect the status, for purposes of this Part, of any indebtedness incurred prior to January 20, 1966."

The present paragraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) of § 204.1 would be redesignated as paragraphs (b), (c), (d), (e), (f), (g), (h), (i), and (j), respectively. The present paragraphs (a), (b), (c), (d), and (e) of § 217.1 would be redesignated as paragraphs (b), (c), (d), (e), and (f), respectively.

If adopted by the Board, it is contemplated that the amendments would be made effective approximately 60 days after the date of their adoption. The amendments would apply not only to any indebtedness within their coverage incurred after the effective date but also to any such indebtedness outstanding on the effective date that was incurred after January 20, 1966.

During the past year, a number of banks have issued promissory notes as a means of obtaining additional funds. It is now apparent that this practice results in avoidance of laws and regulations governing payment of interest on deposits and maintenance of reserves against deposits.

The proposed amendments to Regulations Q and D are designed to prevent evasions of those laws and regulations and are based upon the premise that, with few exceptions, indebtedness of member banks must be considered and treated as deposits subject to Regulations Q and D in order to effectuate Congressional directives and policies, as expressed in section 19 of the Federal Reserve Act.

The amendments are intended principally to bring promissory notes within the definition of deposits. However, the Board would be prepared to adopt similar amendments with respect to other forms of indebtedness that were being used as a means of avoiding laws or regulations relating to payment of interest on deposits and maintenance by member banks of reserves against deposits.

The following are illustrations of the effects of the presently proposed definition of deposits, from the standpoint of rules governing payment of interest on deposits:

(1) In consideration of the receipt of funds, a member bank issues its promissory note (either negotiable or nonnegotiable) to mature in six months. The bank's liability would be a deposit. Consequently, the rate of interest on the note could not lawfully exceed that permitted on a certificate of deposit.

(2) A member bank issues its note payable on demand or within less than 30 days, either negotiable or nonnegotiable. The bank's liability would constitute a demand deposit, and it could not lawfully pay any interest thereon.

(3) A member bank purchases stationery and office supplies on credit. Such indebtedness would not arise from "funds received or credit extended by the bank", and consequently it would not be a deposit.

(4) A member bank borrows funds on its note, secured by a mortgage on the bank premises, and uses the proceeds to pay for renovation. Although this indebtedness would arise from "funds received" by the bank, the transaction would not be "in the ordinary course of its business", and therefore the indebtedness would not constitute a deposit.

(5) A member bank lends funds to a customer and credits the proceeds to his account. The amount so credited would, as heretofore, be a deposit.

(6) A member bank receives funds, in the ordinary course of its business, from a correspondent bank - whether member or non-member, domestic or foreign. Consistent with traditional practice and understanding of the parties, the liability of the recipient bank would be a deposit. The proposed definition of "deposit", however, would except from its coverage an interbank indebtedness that is entered and reported by both banks as a loan transaction. A loan of what are commonly termed "Federal funds" is an example of an indebtedness that would fall within such exception.

(7) A member bank issues debentures or notes to provide additional "capital" funds. By contract, the claim of the security holders against the assets of the bank is subordinated to the claims of depositors and all other creditors. Such notes are excepted from the definition of deposit if they have an original maturity of more than two years.

This notice is published pursuant to section 4 of the Administrative Procedure Act and section 1(b) of the Rules of Procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.1(b)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C., 20551, to be received not later than February 25, 1966.

Dated at Washington, D. C., this 20th day of January, 1966.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 3
1/20/66

For immediate release.

January 20, 1966.

The Board of Governors today announced proposed amendments to its Regulation D, relating to reserve requirements of member banks, and its Regulation Q, relating to the payment of interest on deposits by member banks. The amendments would in effect define "deposits" for purposes of those regulations as including promissory notes and other forms of indebtedness of member banks with certain exceptions.

In general, the exceptions would exclude from coverage (1) borrowings from Federal Reserve Banks, (2) borrowings from other banks, including so-called "Federal funds transactions," (3) borrowings in the form of transfers of United States obligations under repurchase agreements, and (4) borrowings with maturities of more than two years that are subordinated to claims of depositors and general creditors.

The proposed amendments have been prompted by the development over the past year of the practice among some banks of issuing short-term promissory notes to corporate customers and others in order to obtain loanable funds. This practice has tended to lessen the effectiveness of provisions of the Federal Reserve Act that prohibit the payment of interest on demand deposits, limit the rate of interest payable on time deposits, and require reserves against deposits.

The proposed amendments would apply to any indebtedness within their coverage that is incurred after today (January 20, 1966) that is outstanding after the effective date.

Comments on the proposed amendments should be submitted by February 25, 1966. The amendments would not be made effective until approximately 60 days after their adoption by the Board.

The text of the notice regarding the proposed amendments, as it has been sent to the Federal Register, is attached hereto. The notice includes illustrative examples of the manner in which the amendments would affect particular types of transactions.

Attachment.