

Minutes for February 2, 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> <u> </u>
Gov. Robertson	<u> </u> <u> </u>
Gov. Balderston	<u> </u> <u> </u>
Gov. Shepardson	<u> </u> <u> </u>
Gov. Mitchell	<u> </u> <u> </u>
Gov. Daane	<u> </u> <u> </u>
Gov. Maisel	<u> </u> <u> </u>

Minutes of the Board of Governors of the Federal Reserve System
on Wednesday, February 2, 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. Maisel

Mr. Kenyon, Assistant Secretary
Mr. Young, Senior Adviser to the Board and
Director, Division of International Finance
Mr. Holland, 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. Shay, Assistant General Counsel
Mr. Koch, Deputy Director, Division of Research
and Statistics
Mr. Gramley, Associate Adviser, Division of
Research and Statistics
Mr. Sammons, Associate Director, Division of
International Finance
Messrs. Goodman and Leavitt, Assistant Directors,
Division of Examinations
Mrs. Semia, Technical Assistant, Office of the
Secretary
Miss Hart, Senior Attorney, Legal Division
Messrs. Eckert and Fry of the Division of
Research and Statistics
Messrs. Maguire and Maurer of the Division of
Examinations

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on January 31, 1966, of the rates on discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to the Bank.

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Approved letters. The following letters were approved unanimously after discussion of appropriate background information that had been made available to the Board and clarification of points as to which members of the Board inquired. Copies of the letters are attached under the indicated item numbers.

	<u>Item No.</u>
Letter to Washington Trust Bank, Spokane, Washington, approving an investment in bank premises.	1
Letter to Chase International Investment Corporation, New York, New York, granting an extension of time to make previously approved investments in Arcturus Investment & Development Ltd., Montreal, Canada.	2
Letter to the Federal Reserve Bank of Cleveland approving the payment of salaries to Robert D. Duggan as Cashier (Cincinnati Branch) and to James H. Campbell as Assistant Cashier at rates fixed by the Bank's Board of Directors.	3
Letter to the Federal Reserve Bank of St. Louis approving the payment of salaries to Stephen Koptis as Vice President and to Eugene A. Leonard as Assistant Vice President at rates fixed by the Bank's Board of Directors.	4

Proposed commingled investment account (Item No. 5). In response to inquiries by Chairman Patman of the House Committee on Banking and Currency the Board sent to him on December 15, 1965, a memorandum prepared by the Board's Legal Division regarding "Legal Considerations under Section 32 of the Banking Act of 1933 in Connection with the Proposed 'Commingled Investment Account' of First National City Bank of New York."

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In a letter of January 13, 1966, to Chairman Martin, Mr. Patman expressed dissatisfaction with the Board's reply and the findings of the Legal Division, taking exception among other things to the construction placed upon a particular Supreme Court opinion.

There had now been distributed memoranda dated January 27 and 28, 1966, from the Legal Division, the first submitting a draft of reply to Mr. Patman's January 13 letter, and the second setting forth an analysis of Mr. Patman's allegation that the staff had misinterpreted the Supreme Court opinion cited in the Division's earlier document.

Mr. Shay commented that the draft reply had been prepared on the assumption that the House Banking and Currency Committee would hold hearings shortly with respect to the National City matter. Now, however, it was understood that no hearings were in prospect. Therefore, Mr. Shay suggested deletion of certain passages in the draft letter.

Miss Hart mentioned reasons why it had been thought preferable, instead of sending a detailed analysis, to limit the reply to only a few key points.

Governor Robertson expressed the view that the record should not be allowed to stand without adequate refutation of the remarks about the interpretation made by the Board's legal staff. Therefore, he would transmit to Mr. Patman the analytical memorandum of January 28. He also recommended making it clear that the Board had not decided the question of the legal power of First National City Bank to operate the commingled

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investment account. That question rested with the Department of Justice and the Comptroller of the Currency. The only question as to which the Board had jurisdiction fell under section 32, regarding interlocking relationships of officers, directors, and employees of member banks with securities firms that were primarily engaged in certain activities. Governor Robertson suggested changes in the draft letter that would carry out the approach he recommended. He suggested further indicating that if the Department of Justice considered that the proposal of First National City Bank was not precluded by the provisions of section 21 of the Banking Act of 1933, but if the Congress was of the view that a bank should not operate such a plan, amendment of the law might be in order.

There was general agreement with the approach Governor Robertson had outlined, and a reply to Chairman Patman in the form attached as Item No. 5 was thereupon approved unanimously.

Reserve requirements on time deposits (Item No. 6). The Board had previously discussed questions involved in the response to be made to inquiries by Congressman Reuss, raised at hearings before the Joint Economic Committee in December 1965, as to the significance of reserve requirements against time deposits and the possible desirability of increasing those requirements as an anti-inflation measure. A revised draft reply, reflecting views expressed by members of the Board at the January 28 meeting, had now been distributed.

Mr. Brill reviewed the background of the matter and reported on progress in staff studies relating to various aspects of reserve requirements, including analysis of alternative plans for a system of graduated

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reserve requirements and analysis of the question of establishing a higher requirement on negotiable certificates of deposit.

Discussion of the reply to be made to Mr. Reuss included comments on the desirability of avoiding language that might be construed as foreshadowing any specific action by the Board. There was agreement on several suggestions by members of the Board for rearrangement of the contents of the proposed letter and for changes in emphasis.

At the conclusion of the discussion it was understood that the letter would be transmitted to Congressman Reuss in a form revised to reflect the views that had been expressed.

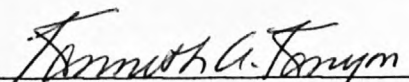
Secretary's Note: Subsequent to the meeting an additional question relating to one portion of the letter was raised. The matter was therefore returned for further consideration by the Board on February 3, 1966, and approval then was given to a letter to Congressman Reuss in the form attached as Item No. 6 .

The meeting then adjourned.

Secretary's Note: On February 1, 1966, Governor Shepardson approved on behalf of the Board the following items:

Memorandum dated January 26, 1966, from Mr. Koch, Deputy Director, Division of Research and Statistics, and Chairman of the Staff Economic Seminar Committee, requesting authorization for absorption in the 1966 budget of the Division of Research and Statistics of charges not exceeding \$400 for seminar expenses. It was understood that transportation expenses and a per diem in lieu of subsistence would be paid, when required, in accordance with the Board's travel regulations.

Memorandum from the Division of Data Processing dated January 28, 1966, concerning the Board's earlier approval of the purchase of a Dataplotter System Series 3500 for \$62,205 and requesting authorization to order an engineering modification for this equipment which would add \$155 to the purchase price.


Assistant Secretary

Item No. 1
2/2/66

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



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 2, 1966.

Board of Directors,
Washington Trust Bank,
Spokane, Washington.

Gentlemen:

Pursuant to the provisions of Section 24A of the Federal Reserve Act, the Board of Governors of the Federal Reserve System approves an investment in bank premises of \$275,000 by Washington Trust Bank, Spokane, Washington, for a piece of property adjoining your present main office building.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 2
2/2/66



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 2, 1966.

Chase International Investment Corporation,
One Chase Manhattan Plaza,
New York, New York. 10005

Gentlemen:

Reference is made to your letter of January 17, 1966, referring to the Board's letter of February 1, 1965, (and previous letters) which authorized your Corporation, subject to various conditions, to make further investment in Arcturus Investment & Development Ltd., ("Arcturus"), Montreal, Canada, (in form of stock or obligations) up to an amount not to exceed US\$7,500,000. The Board's letter of February 1, 1965, extended to February 1, 1966, the time within which such investment might be made.

In accordance with your request and on the basis of the information furnished, the Board extends to February 1, 1967, the time within which further investment may be made in Arcturus (in form of stock or obligations) up to an amount which, with the existing investment, would not exceed US\$7,500,000.

The foregoing consent is given with the understanding that additional investments made under this authorization, combined with other foreign loans and investments of your Corporation, The Chase Manhattan Bank (National Association), and Chase Manhattan Overseas Banking Corporation, will not cause the total of such loans and investments to exceed the guidelines established under the voluntary foreign credit restraint effort now in effect and that due consideration is being given to the priorities contained therein.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

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

Item No. 3
2/2/66



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 2, 1966.

CONFIDENTIAL (FR)

Mr. W. Braddock Hickman, President,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio. 44101

Dear Mr. Hickman:

The Board of Governors has approved the payment of salary to officers of the Federal Reserve Bank of Cleveland listed below for the period March 1 through December 31, 1966, at the following rates fixed by your Board of Directors, as reported in your letter of January 27, 1966.

<u>Name</u>	<u>Title</u>	<u>Annual Salary</u>
Robert D. Duggan	Cashier (Cincinnati Branch)	\$15,000
James H. Campbell	Assistant Cashier	12,500

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 4
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ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 2, 1966.

CONFIDENTIAL (FR)

Mr. Darryl R. Francis, President,
Federal Reserve Bank of St. Louis,
St. Louis, Missouri. 63166

Dear Mr. Francis:

The Board of Governors has approved the payment of salary to officers of the Federal Reserve Bank of St. Louis listed below for the period February 1 through December 31, 1966, at the following rates fixed by your Board of Directors, as reported in your letter of January 27, 1966.

<u>Name</u>	<u>Title</u>	<u>Annual Salary</u>
Stephen Koptis	Vice President	\$20,000
Eugene A. Leonard	Assistant Vice President	15,000

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

Item No. 5
2/2/66BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

February 4, 1966

The Honorable Wright Patman, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C. 20515

Dear Mr. Chairman:

This refers to your letter of January 13, 1966, which discusses the memorandum furnished you with my reply of December 15, 1965, to your letters of October 26 and November 24, 1965. That memorandum, prepared by the Board's Legal Division, is entitled "Legal Considerations Under Section 32 of the Banking Act of 1933 in Connection with the Proposed 'Commingled Investment Account' of First National City Bank of New York". Enclosed is a memorandum of our legal staff with respect to your chief objection to the earlier memorandum.

It must be emphasized that the only question decided by the Board in its interpretation concerning the proposal of First National City Bank was that interlocking service relationships between the bank and the account, on the basis of the Board's understanding of the matter, would not be prohibited by section 32 of the Banking Act of 1933. Whether a national bank has legal power to operate such an account, under the Banking Act of 1933 and other relevant banking statutes, is a matter that falls within the jurisdiction of the Comptroller of the Currency, rather than this Board. The Comptroller, as you know, has determined that it would be lawful for First National City Bank to operate the proposed account. It should be clear, therefore, that the Board has not expressed its approval or disapproval of the establishment and operation of the proposed account.

Section 21 of the Banking Act of 1933 forbids persons and specific organizations engaged in certain aspects of the securities business to engage at the same time to any extent whatever in the business of receiving deposits. By implication, the statute forbids any commercial bank to be so engaged (subject to certain exceptions

The Honorable Wright Patman -2-

in the statute) in securities activities of the kinds described therein. Since section 21 is a criminal statute, its interpretation and application are matters for the Department of Justice and the courts, as explained in my letter to you of December 15, 1965.

Section 20 of the Banking Act of 1933 is directed at divorcing commercial banks from affiliates, as therein defined, engaged principally in the securities business, while an object of section 32 of the Act was to cover specific interlocking service relationships between commercial banks and securities dealers or organizations that section 20 might not prevent.

In your letter of January 13, 1966, you questioned whether interlocking service is required to bring the prohibition of section 32 into play. The Board's conclusion that section 32 is directed at interlocking relationships is based on the language of the statute itself, which says that no person primarily engaged in certain described areas of the securities business "shall serve [at] the same time as an officer, director, or employee of any member bank" (Emphasis supplied.) Since section 32 was revised in 1935, the Board has consistently based its interpretations on this understanding of the statutory language. The Supreme Court of the United States, apparently, also has interpreted the statute in this way:

"Section 32 was designed . . . to remove tempting opportunities from the management and personnel of member banks. In no realistic sense do those opportunities disappear merely because the underwriting activities of the outside firm with which the officer, director, or employee is connected happens to fall below 51 per cent." (Emphasis supplied.) Board of Governors v. Agnew, 329 U.S. 441, 449 (1947)

In determining that section 32 would not prohibit interlocking service relationships between First National City Bank and its proposed commingled investment account, the Board concluded that the account would form an integral part of the operation of the bank's trust department and, consequently, that the prohibition of section 32 was inapplicable.

If the Department of Justice should consider that the proposal of First National City Bank to operate a commingled investment account is not within the prohibition of section 21, and members of your Committee believe, as a matter of policy, that banks should not operate such accounts, then your Committee might wish to consider appropriate legislative amendments.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 6
2/2/66

OFFICE OF THE CHAIRMAN

February 4, 1966.

The Honorable Henry S. Reuss,
House of Representatives,
Washington, D. C. 20515

Dear Mr. Reuss:

During the Joint Economic Committee's hearings last month you requested comments on whether reserve requirements on time deposits are meaningless, on the desirability of raising reserve requirements on time deposits as an anti-inflationary measure, and on the desirability of a higher reserve requirement on negotiable certificates of deposit.

The Board believes that the present authority is not meaningless, and should be continued. The desirability of maintaining reserve requirements against deposits stems, in the main, from the contribution they make to effective functioning of monetary and credit policies. Abolition of reserve requirements against time deposits would widen significantly the differential between requirements on demand and time accounts. Shifts in public preferences between these two classes would, in these circumstances, complicate the task of monetary policy by tending to produce even wider fluctuations in total bank credit and bank deposits than occur under present arrangements.

This does not imply, however, that reserve requirements against time deposits should be equal to those on demand deposits. The public also readjusts its financial asset portfolios by shifting between time deposits and claims against nonbank financial intermediaries, and between time deposits and market securities. The effects of these shifts on financial market conditions, and on economic activity and prices, are minimized when reserve requirements on time deposits are relatively low.

Required reserves on time deposits also provide some liquidity to individual banks. Liquidity is needed because savings accounts are effectively payable on demand, and certificates and other time deposits are potentially volatile and display higher turnover rates than savings deposits. The automatic availability of cash through required reserves to meet deposit withdrawals amounts to a small proportion of any deposit loss, but the contribution to individual bank liquidity is not negligible. Abolition of such reserve requirements would thus increase the supervisory difficulties of bank regulatory agencies in insuring that banks maintain adequate liquidity.

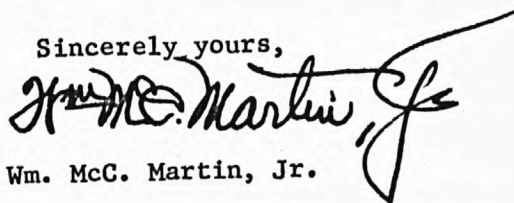
The Honorable Henry S. Reuss - 2 -

Operational considerations also lead to the conclusion that reserve requirements against time deposits should be retained. Removal of these reserve requirements would require offsetting actions by the Federal Reserve to absorb the reserves released to prevent excessive expansion of bank credit, in the course of which serious adjustment problems might arise for many individual banks, since the mixture of deposits between demand and time accounts varies markedly among banks of different sizes and in different locations.

Equity considerations might seem to favor removal of reserve requirements against time deposits at member banks, since other intermediaries are not required to hold noninterest-bearing assets. You will recall that the President's Committee on Financial Institutions took the position that these inequities should be corrected by requiring (a) that all commercial banks be subject to the reserve requirements specified by the Federal Reserve, and (b) that reserve requirements similar to those on time and savings deposits at commercial banks be introduced for shares at savings and loan associations and deposits at mutual savings banks.

As you know, the Board has been authorized to adjust reserve requirements on time deposits in response to developments in the economy. We do not conceive of this as a decision that can be made in the abstract, once and for all. We have had a wide variety of aspects of this problem under review and expect to continue to review possible use of this authority, along with other measures, in the light of economic conditions as they develop.

Sincerely yours,



Wm. McC. Martin, Jr.