Minutes for February 9, 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 WM

Gov. Robertson R

Gov. Balderston V

Gov. Shepardson

Gov. Mitchell

Gov. Daane

Gov. Maisel SJM

Minutes of the Board of Governors of the Federal Reserve System on Wednesday, February 9, 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. Maisel

Mr. Kenyon, Assistant Secretary
Mr. Holland, Adviser to the Board
Mr. Solomon, Adviser to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Associate General Counsel
Messrs. O'Connell, Shay, and Hooff, Assistant General Counsel
Mr. Koch, Deputy Director, Division of Research and Statistics
Messrs. Axilrod and Smith, Associate Advisers, Division of Research and Statistics
Mr. Sammons, Associate Director, Division of International Finance
Mrs. Semia, Technical Assistant, Office of the Secretary
Messrs. Forrestal and Sanders of the Legal Division
Messrs. Egertson and Poundstone of the Division of Examinations

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

	Item No.
Letter to Girard Trust Bank, Philadelphia, Pennsylvania, approving the establishment of a branch in Lansdale.	1

Letter	Item No.
Letter to The Elyria Savings & Trust Company, Elyria, Ohio, approving the establishment of a branch at 223 North Abbe Road.	2
Letter to St. Charles Savings Bank, St. Charles, Missouri, approving the establishment of a branch at 210 North Fifth Street.	3
Letter to Mexico Savings Bank, Mexico, Missouri, approving the establishment of a branch near Western Avenue and Promenade Street.	4
Letter to United California Bank, Los Angeles, California, approving the establishment of a branch in Bakersfield.	5
Letter to Chase International Investment Corporation, New York, New York, approving an amendment to its Articles of Association.	6
Letter to the Federal Reserve Bank of New York regarding a member bank acting as a medium or agent of a corporation making loans to Government securities dealers, and regarding the status of such loans under the seventh paragraph of section 19 of the Federal Reserve Act. (With copies to all Federal Reserve Banks.)	7

Reports on competitive factors. A report to the Comptroller of the Currency on the competitive factors involved in the proposed merger of Billings State Bank, National Association, with First National Bank in Billings, both in Billings, Montana, was approved unanimously for transmittal to the Comptroller. The conclusion read as follows:

> While three alternative banking options would remain in Billings, the merger of First National Bank in Billings and Billings State Bank, National Association, would eliminate the competition existing between the proponents. In this regard, the effect on competition would be adverse.

A revision of the proposed conclusion having been agreed upon, unanimous approval was given to the transmittal to the Federal Deposit Insurance Corporation of a report on the competitive factors involved in the proposed merger of Cooke Trust Company, Ltd., into First National Bank of Hawaii, both in Honolulu, Hawaii. In the form in which approved, the conclusion read as follows:

> There appears to be no significant competition existing between First National Bank of Hawaii, Honolulu, Hawaii, and Cooke Trust Company, Ltd., Honolulu, Hawaii.

Report on "Participation Sales Act of 1966" (Item No. 8). There had been distributed a memorandum dated February 8, 1966, from the Legal Division regarding the request of the Bureau of the Budget for the Board's views on a draft bill entitled "Participation Sales Act of 1966." The stated objectives of the proposed bill were "to promote private financing of credit needs and to provide for an efficient and orderly method of liquidating financial assets held by Federal credit agencies...".

The proposed bill was an Administration measure about which the following comments had been included in the Federal budget transmitted to Congress in January 1966: "All major direct loan programs of the Federal Government have recently been evaluated with the objective of substituting private for public credit wherever feasible and consistent with the purposes of the programs. On the basis of this evaluation, legislation is being recommended to make a broader range of Federal loans available for private investment by authorizing sales of participations in pools of such loans. In the past, such participation sales have been highly successful in expending the market for loans of the Export-Import Bank, the Federal National Mortgage Association and the Veterans Administration."

Attached to the memorandum was a draft of reply to the Budget Bureau that would state that the enactment of the proposed legislation would necessarily result in somewhat higher interest costs to the Government than would be likely if the same volume of funds were raised directly through the sale of U.S. Treasury obligations. The draft would also recommend that if the bill were enacted, special attention be given to tailoring the maturities of certificates to meet investor requirements so that the large volume of offerings could be absorbed in financial markets as smoothly as possible.

During discussion of the proposed letter it was agreed to eliminate, as gratuitous, a paragraph recommending that the language of the bill be amended so as to make mandatory the designation of the Federal National Mortgage Association as trustee of any trusts established by executive departments or agencies in regard to the sale of participation certificates. It was also agreed to eliminate the sentence indicating that every effort should be made to tailor the distribution of maturities as closely as possible to the needs of investors in the market place; this deletion had been suggested on the ground that the matter could be taken up, as necessary, on an interagency basis. It was agreed, however, to retain a sentence urging that, if the bill should be approved and sales of participation certificates were expanded under its terms, care be taken to minimize the risk of putting undue pressure on any single sector of the domestic financial markets.

The discussion of the draft bill also dealt with the implications of the program in terms of the cost of Government financing. It was noted that basically it would appear desirable to raise all of the money needed for Government activities through the sale by the Treasury of U.S. Government obligations; agency issues did not enjoy as ready a market as direct U.S. obligations and therefore normally carried a higher rate of interest. The proposed program, it seemed, might give impetus to the use of agency securities. On the other hand, it was pointed out that agency financing sometimes reflected restrictions imposed by the Treasury debt limit and by the ceiling interest rate on direct Treasury obligations. In addition, the program would provide certain advantages in terms of this year's Federal budget and to this extent involved a question of Administration policy on which it might be inappropriate for the Board to express a position. Also, to the extent that agency financing was conducted, the apparatus contemplated by the proposed bill would provide Government agencies with a more efficient method of selling participation certificates in pools of loans.

The implications of the proposal in relation to the execution of monetary policy were also mentioned, including the question whether it was envisaged that System open market operations would be conducted in the participation certificates.

At the conclusion of the discussion unanimous approval was given to a letter to the Bureau of the Budget in the form attached as Item No. 8.

Inquiry regarding negotiable certificates and promissory notes (Item No. 9). There had been distributed a draft of reply to a request from Chairman Patman of the House Committee on Banking and Currency for a "considered legal opinion" on two questions: (1) whether it was legal for commercial banks to issue negotiable certificates of deposit and to treat the sums so received as time deposits, and (2) whether or not promissory notes might legally be issued by commercial banks.

After a discussion during which there was agreement on certain clarifying changes in one part of the draft reply, the letter was approved unanimously in the form attached as Item No. 9.

Compounding of interest (Item No. 10). Pursuant to the discussion at the meeting on January 19, 1966, there had been distributed a memorandum dated February 3, 1966, from the Legal Division submitting and commenting on a draft notice of proposed rule making with respect to a possible amendment to Regulation Q, Payment of Interest on Deposits, that would permit member banks to compound interest on deposits at the maximum permissible rate more frequently than the quarterly intervals now permitted under the Regulation. The memorandum suggested that before such a proposal was published in the Federal Register the Board might want to request the views of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Banks.

As the proposed amendment was drafted, it contained options, for the Board's choice, to permit member banks to compound interest on deposits either monthly or daily at the maximum permissible rate. The rule-making notice would point out that at present interest could be compounded monthly or daily, but that the amount of interest so compounded could not exceed the amount of interest at the maximum permissible rate when compounded quarterly. The purpose of the proposed amendment would be to permit member banks greater flexibility in contracting and in operations with respect to interest on deposits. However, adoption of the amendment would have an insignificant quantitative effect on the maximum permissible interest that member banks could pay for the use of funds.

During discussion it was observed that although the proposed change might be attractive to some banks for advertising purposes, the interest rate effect would be minimal. Also, although banks that used computers would find it easiest to take advantage of the proposed amendment, it was suggested that there might not be any great problem for other banks because interest tables should be quickly available from financial publishers.

There was agreement with a suggestion for a change in the draft notice that would substitute for the reference to monthly (or daily) compounding a statement that a bank could compound on any basis it chose to adopt. There was also agreement that at the present time the proposal should be sent only to the Federal Reserve Banks for comments, the solicitation of views from others to be deferred for the time being.

At the conclusion of the discussion unanimous approval was given to a letter, a copy of which is attached as Item No. 10, requesting the views of the Federal Reserve Banks on the proposal as revised in accordance with the comments at today's meeting.

Chase Manhattan-Liberty National proposal (Item No. 11). There had been distributed a memorandum dated February 8, 1966, from Mr. Hackley regarding the proposal of The Chase Manhattan Bank (National Association), New York, New York, to acquire stock of Liberty National Bank and Trust Company, Buffalo, New York, which the Comptroller of the Currency had held to be subject to his approval under the Bank Merger Act. (The Board had submitted to the Comptroller a competitive factor report that, among other things, stated that the report should not be regarded as indicative of the Board's views as to whether the transaction fell within the scope of the Bank Merger Act or violated other provisions of Federal law, including the stock purchase provisions of R. S. 5136, the branch provisions of R. S. 5155, and section 7 of the Clayton Act.)

Mr. Moroney, General Counsel of the Federal Deposit Insurance Corporation, had informed Mr. Hackley that the Corporation had sent the Comptroller a letter stating in effect that in its opinion the Bank

Merger Act was not applicable to the transaction and that therefore the Corporation was not required to submit a competitive factor report, but that, apart from that point, the transaction would have an adverse effect on competition. Mr. Moroney had then said that Chairman Randall was considering the desirability of asking the Secretary of the Treasury to request from the Attorney General an opinion as to (1) the applicability of the Merger Act in this case and (2) the legality of the proposed transaction, with the thought that the Secretary at the same time might ask the Comptroller to defer announcement of his decision pending receipt of such an opinion. The question raised was whether Chairman Martin would join in such a request of the Secretary.

The Corporation felt, the memorandum continued, that if Chase Manhattan's proposed transaction was consummated, it was unlikely that anyone would then question its legality in the courts or in Congress, and consequently a precedent would be established for similar acquisitions by Chase and other banks. For that reason, it seemed desirable to determine the legality of the transaction through an opinion of the Attorney General before the Comptroller acted on the application. It was recognized that Secretary Fowler might not be willing to request the opinion of the Attorney General or to ask the Comptroller to defer action pending receipt of such an opinion. Furthermore, the Attorney General might not agree to render an opinion, and even if he did, it probably would be some time before the opinion was handed down. However, the issues involved in the case were of great importance, with far-reaching implications for the country's banking structure, and there appeared to be merit in the argument that, if the legality of the transaction was not now tested in the manner suggested, it might be difficult, as a practical matter, to test the transaction's legality after it had been consummated. While Chase Manhattan had applied to the Board for a permit to vote the stock of Liberty National (or, in the alternative, an exemptive determination under section 301), it might be possible for Chase to control Liberty National without voting its stock.

The Board had already advised Chase Manhattan tentatively that the transaction would violate the stock-purchase prohibition of R. S. 5136 and circumvent the branch provisions of R. S. 5155. (Chase Manhattan had been afforded an opportunity to submit arguments on those questions, and its counsel had indicated that a memorandum on the questions would be submitted after the Comptroller's approval of the transaction.) However, if Chase Manhattan should proceed to consummate the transaction without requesting a voting permit, the Board would be powerless, as a practical matter, to prevent a national bank from similarly acquiring the stock of one other bank, even (as in the Chase case) in a place in which it could not lawfully establish branches. If, as the Comptroller maintained, the Bank Merger Act was applicable to the transaction on the ground that it involved an indirect acquisition of bank assets under that Act, it was possible and perhaps likely that the Comptroller would take the position that the acquisition by Chase Manhattan of the stock of a second bank would not fall within the scope of the Bank Holding Company Act, because that Act did not apply to asset acquisitions by a bank. Presumably, the Board would take the contrary position on the ground that such a transaction clearly would involve the acquisition of stock of a bank. However, such a situation could mean that the Comptroller might approve a transaction under the Merger Act and the Board might disapprove the transaction under the Holding Company Act. Since the Department of Justice was responsible for enforcement of the Holding Company Act, it would seem particularly appropriate for the Department to express its views on whether a transaction like that proposed by Chase Manhattan was subject to the Merger Act or (if two banks were involved) to the Holding Company Act or to both of those Acts.

Mr. Hackley's memorandum concluded with his recommendation that the Board indicate its concurrence in the proposal of the Federal Deposit Insurance Corporation.

In a review of the matter at the Board's request, Mr. Hackley summarized developments relating to the proposal of Chase Manhattan, his comments being based substantially on the memorandum that had been distributed.

Governor Maisel asked whether the Board would not be bound by an opinion of the Attorney General if such an opinion was requested.

Upon affirmative reply by Mr. Hackley, he observed that it should be recognized that the suggested procedure might have the effect of moving the decision from the Board's jurisdiction to that of the Attorney General.

Other comments related to possible alternative procedures (which were discarded), the possibility that the Comptroller might announce his decision in the near future, and the time when action on the Chase Manhattan proposal by the New York State authorities was required (not later than February 19).

At the conclusion of the discussion it was agreed unanimously that Chairman Martin should join Chairman Randall in approaching the Secretary of the Treasury with the Federal Deposit Insurance Corporation's suggestion, and that the staff would prepare a letter containing a factual statement of the circumstances that Chairman Martin might hand to the Secretary if he desired.

> Secretary's Note: Attached as Item No. 11 is a copy of the letter transmitted to Secretary Fowler by Chairman Martin.

Merger and holding company applications. There had been distributed a draft of letter to the Presidents of the Federal Reserve Banks outlining steps looking toward improvement in the analysis and presentation of bank merger and holding company applications and toward expediting their processing.

During discussion members of the Board suggested several changes in the draft, and it was agreed that the draft would be reviewed in light of those comments, along with suggestions that were to be conveyed to the staff by Governor Robertson.

The meeting then adjourned.

Secretary's Notes: On February 8, 1966, Governor Shepardson approved on behalf of the Board a memorandum from Mack Rowe, Chief, Economic Graphics Section, Division of Data Processing, requesting permission to teach a course in Production of Instructional Materials at the Northern Virginia Center of the University of Virginia.

Governor Shepardson today approved on behalf of the Board the following items:

Letter to the Federal Reserve Bank of Chicago (attached Item No. 12) approving the appointment of Bonnie Jeane Gray as assistant examiner.

Memoranda recommending the following actions relating to the Board's staff:

Salary increases

Ann R. Clary, Librarian, Division of Research and Statistics, from $8,241 to $8,961 per annum, with a change in title to Assistant Chief Librarian, effective February 13, 1966.

Charles M. Wrenn, Digital Computer Programmer, Division of Data Processing, from $6,476 to $7,479 per annum, effective February 13, 1966.

Acceptance of resignation

Mary C. Wing, Technical Editor (Economics), Division of Research and Statistics, effective at the close of business February 7, 1966.

Permission to engage in outside activity

Harry Allan Tomkinson, Statistical Clerk, Division of Research and Statistics, to work as an auto mechanic on a part-time basis.

Kenneth A. Kenyon
Assistant Secretary

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

Item No. 1
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Board of Directors,
Girard Trust Bank,
Philadelphia, Pennsylvania.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Girard Trust Bank, Philadelphia, Pennsylvania, of a branch in the South Broad Shopping Center, South Broad Street and Hancock Avenue, Lansdale, Montgomery County, Pennsylvania, provided the branch is established within six months 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
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Board of Directors,
The Elyria Savings & Trust Company,
Elyria, Ohio.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by The Elyria Savings & Trust Company, Elyria, Ohio, of a branch at 223 North Abbe Road, Elyria, Ohio, 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. 3
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Board of Directors,
St. Charles Savings Bank,
St. Charles, Missouri.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by St. Charles Savings Bank, St. Charles, Missouri, of a branch (drive-in, walk-up facility) at 210 North Fifth Street, St. Charles, Missouri, provided the branch is established within nine months 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. 4
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Board of Directors,
Mexico Savings Bank,
Mexico, Missouri.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Mexico Savings Bank, Mexico, Missouri, of a branch (drive-in, walk-up facility) in the vicinity of the intersection of Western Avenue and Promenade Street, Mexico, Missouri, 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. 5
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

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

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by United California Bank, Los Angeles, California, of a branch in the vicinity of the intersection of Ming Avenue and Wible Road, Bakersfield, Kern County, California, 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. 6
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

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

Gentlemen:

Reference is made to your letter dated January 18, 1966, enclosing a Consent signed under date of January 17, 1966, on behalf of The Chase Manhattan Bank (National Association), sole shareholder of your Corporation, consenting to the amendment of the Articles of Association of your Corporation to increase the capital stock to $9,000,000 consisting of 90,000 shares of the par value of $100 each.

The Board of Governors approves the amendment to Article SEVENTH. Please advise the Board when the capital increase has been effected.

It is understood that The Chase Manhattan Bank (National Association) will invest an additional $8,000,000 which will be added to surplus, but this amount will be taken down in the future as needed.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 7
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Mr. Fred W. Piderit, Jr.,
Vice President,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Piderit:

This refers to Mr. Crosse's letters of May 19 and July 24, 1964, regarding the seventh paragraph of section 19 of the Federal Reserve Act, which forbids a member bank to "act as the medium or agent of any nonbanking corporation . . . in making loans on the security of stocks, bonds, and other investment securities to brokers or dealers in stocks, bonds, and other investment securities."

In his letter of May 19, Mr. Crosse referred to the possible application of this statutory provision to a situation where a member bank informs the treasurer of a corporation with excess short-term balances that a particular Government securities dealer or dealers may wish to borrow short-term funds. The bank would not participate in the ensuing negotiations between the corporation and the dealer.

The Board's views were requested with respect to (1) whether a bank engaged in such practices should be held to be acting as the "medium or agent" of the corporation involved and (2) whether such loans come within the purview of the seventh paragraph of section 19.

The legislative history of the Banking Act of 1933 (of which said paragraph is a part) does not reveal the purpose of Congress in using the phrase "medium or agent" therein. Accordingly, it must be interpreted in the light of the ordinary meaning and legal interpretation of the words themselves.

The general meaning of the words "medium" and "agent", as well as their legal definitions, leads the Board to conclude that their use in the statute was intended to preclude member banks from actively participating in bringing nonbanking interests and dealers together for the purpose of making loans on securities, or arranging such loans, and to prohibit them from serving in a representative capacity in such loan transactions. A member bank which simply gives information concerning the possible placement of excess funds to a corporate customer requesting such information would not be participating in bringing the parties together, arranging a loan, or representing the parties, and, consequently should not be considered a medium or agent in the transaction.

This interpretation of the statutory provision is applicable only to the factual situation described. That is to say, so long as the member bank confines itself strictly to providing information requested of it concerning the identity of possible borrowers of excess funds, the bank would not be acting as a medium or agent of the lending corporation. If, however, the bank were to contact either party or attempt to bring them together, or participate in the negotiation of the loan, it might be acting as a medium or agent in violation of section 19.

It is the Board's view that the loans of the types which were described in Mr. Crosse's letters come within the purview of the statutory provision. The Senate Banking Committee of the 73rd Congress stated, in its Report No. 77, that its proposal was intended to prevent "speculative market loans", and the Senate Committee of the 72nd Congress made an identical statement in its Report on S. 4412 (S. Rep. No. 584, 9).

However, these statements were made, according to the Committee itself, to outline "in general broad terms the main objects . . ., although without endeavoring to do more than suggest the major features". In each case the statement was followed by a review of the actual provisions of the bill "in order to indicate the precise content of the various sections". The Committee there pointed out that the relevant section would apply to secured loans to dealers in "stocks, bonds, and other investment securities". (S. Rep. No. 584, 13-14; S. Rep. No. 77, 13, 15). As will be noted, in this description of the precise content of the provision, the entire field of "investment securities" was referred to, and the scope of the provision was not described as confined to speculative market loans.

In any event, although the comments of a Committee of the Senate are entitled to some weight, the terms of the statutory provision enacted by Congress are of principal significance. The seventh paragraph of section 19, quoted above, refers to "loans" without limitation; it is not, in terms, confined to speculative loans. It also seems significant that the statute explicitly refers to loans to dealers in bonds and other investment securities as well as to dealers in stocks.

In addition to the legal difficulty in interpreting the words of the seventh paragraph as confined to speculative loans, it might be extremely difficult, in practice, to determine whether particular loans were "speculative". Since dealers in obligations of the United States Government often deal in other securities as well, it might be uncertain whether the purpose of the loan was or was not speculative.

It would seem that this could hardly be determined by the nature of the collateral; since Congress referred to "loans on the security of . . . investment securities" generally, it seems clear that loans subject to the paragraph (including speculative loans) could be secured by United States Government obligations as well as other securities. This difficulty of distinguishing speculative from nonspeculative loans may have been one reason for Congress' decision to cover loans to brokers and dealers generally, even though the principal purpose of the legislation was to prevent speculative loans.

It is also to be noted that Congress, in enacting the Banking Act of 1933, included special provisions relating to obligations of the United States in situations where this was considered appropriate. Among these were the amendments to the eighth paragraph of section 13 of the Federal Reserve Act, the second paragraph of section 23A of that Act, and paragraph Seventh of section 5136 of the Revised Statutes. In view of this legislative advertence to the special status of Government securities transactions in other sections of the 1933 Act, it would be more difficult to infer that a similar intent existed with respect to the seventh paragraph of section 19 and that Congress inadvertently failed to express that intent.

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. 8
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966.

Mr. Phillip S. Hughes, Assistant Director
for Legislative Reference,
Bureau of the Budget,
Washington, D. C. 20503

Dear Mr. Hughes:

This is in reply to your Legislative Referral Memorandum of January 31, 1966, which requested the Board's views on a draft bill "To promote private financing of credit needs and to provide for an efficient and orderly method of liquidating financial assets held by Federal credit agencies and for other purposes."

The draft bill would authorize

(1) executive departments, agencies, and instrumentalities of the United States to subject any obligations held by them to a trust or trusts from which the trustee would be empowered to sell beneficial interests or participations to private investors;

(2) FNMA to act as the trustee for any such trusts;

(3) the executive agency creating the trust to guarantee to the trustee the timely payment of the obligations held in trust; and

(4) the sale of beneficial interests or participations by FNMA even if aggregate receipts from obligations subject to the trust are insufficient to provide for payment by the trustee on such participations.

Participations or other instruments issued pursuant to the terms of the proposed legislation would be "exempt securities" within the meaning of laws administered by the Securities and Exchange Commission.

The draft bill would also amend Title III of the Higher Education Facilities Act of 1963 in order to create within the Treasury a revolving fund for higher education facilities loans.

This bill would provide Government agencies with a more efficient method of selling participation certificates in pools of Federally owned loans and with the opportunity to expand such sales. While one objective of the bill is to achieve certain budgetary results that will follow if more participation certificates are sold, it should be recognized that the market has not given such certificates as favorable a reception as direct U. S. Government securities. As a result, such sales obtain funds for the Government only at a somewhat higher interest cost than would be incurred by the sale of an equivalent amount of direct U. S. obligations.

If this bill is approved and sales of participation certificates are expanded under its terms, the Board urges that extreme care be taken to minimize the risk of putting undue pressure on any single sector of the domestic financial markets.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

Item No. 9
2/9/66

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

February 9, 1966.

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

Dear Mr. Chairman:

This is in response to your letter of February 1, requesting a "considered legal opinion" on two questions:

(1) "whether it is legal for commercial banks to issue . . . negotiable certificates of deposit and to treat the sums so received as time deposits";

(2) "whether or not promissory notes may legally be issued by commercial banks".

No law or regulation administered by the Federal Reserve System forbids commercial banks to issue negotiable certificates of deposit or promissory notes or to treat funds received for certificates of deposit as time deposits. In general, the powers of commercial banks are derived from the laws that provide for their organization, regulation, and supervision. The statutory provisions governing the powers of national banks are in the National Bank Act and other Federal laws principally administered by the Comptroller of the Currency. In the case of State banks, powers are derived chiefly from the banking laws and regulations of the respective States, which are applied and enforced by the State supervisory authorities. We understand that your inquiry has been addressed also to the Comptroller of the Currency, and you may deem it advisable to request the opinions of State banking authorities. I am enclosing a "Compilation of State Statutes Respecting Limitations on Amounts Banks Can Borrow", which may be of some assistance in your study of this matter, although neither the Compilation nor the Summary included therein should be regarded as authoritative.

Section 5202 of the Revised Statutes (12 U.S.C. 82) appears to recognize the authority of national banks to borrow, and it is believed that the National Bank Act has been interpreted, throughout its history, as permitting national banks to issue promissory notes. Judicial decisions relating to the powers of national banks to borrow are collected in Note 205 to section 24 of Title 12 of the U.S. Code Annotated.

Section 24 of the Federal Reserve Act (12 U.S.C. 371), as originally enacted in 1913, provided that national banks "may continue hereafter as heretofore to receive time deposits and to pay interest on the same." The McFadden Act of 1927 (44 Stat. 1232) amended this provision to read substantially as it does at the present time:

> "Any such association may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located."

The foregoing enactments appear to reflect a legislative intent to confirm the authority of national banks to accept "time deposits" as well as "savings deposits". In recent decades, at least, the certificate of deposit has been the principal instrument issued by commercial banks by which receipt of time deposits has been evidenced. The Banking Act of 1933 (48 Stat. 182) added to section 19 of the Federal Reserve Act a provision that is now (in amended form) the thirteenth paragraph thereof. That enactment directed the Board

> "from time to time /to/ limit by regulation the rate of interest which may be paid by member banks on time deposits, and /the Board/ may prescribe different rates for such payment on time and savings deposits"

according to enumerated criteria. Although subsequent legislation has amended the provision in some respects, it has continued to reflect Congressional recognition that receipt of time deposits is a usual, and presumably legitimate, activity of commercial banks. The first paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 461) authorizes the Board of Governors to define the term "time deposits" and a number of related terms.

Pursuant to the statutory direction mentioned in the preceding paragraph, Regulation Q of the Board of Governors (12 CFR 217) regulates the payment of interest on time and savings deposits by banks that are members of the Federal Reserve System. Section 217.1(b) defines the term "time deposits" to mean "time certificates of deposit" and "time deposits, open account". Section 217.1(c) provides that a "time certificate of deposit" may be either negotiable or nonnegotiable.

Although Regulation Q does not constitute a source of banking powers for member banks, it evidences the Board's belief that many member banks, if not all, possess legal authority to issue certificates of deposit in negotiable form.

Certificates of deposit actually have been issued in substantial amounts by both national banks and State banks for many years. It is not known to what extent certificates of deposit were issued in negotiable form prior to the 1960's. As you are aware, in the last few years the use of negotiable certificates of deposit, issued principally in large denominations by metropolitan banks, has increased greatly.

The question whether commercial banks may legally issue promissory notes can be approached from several directions. A promissory note may be negotiable or nonnegotiable, may be payable on demand or have a maturity of a few days or 30 years, and may arise from individual negotiation or be part of a large issue of identical instruments in the nature of investment securities. In recent years, a number of banks have issued long-term "capital notes", subordinated to deposits but senior to equity capital, for the purpose of strengthening the "capital cushion" that protects deposits as well as obtaining additional funds to lend or invest. In contrast to notes of that type, and coming into common use even more recently, are promissory notes in large denominations, with maturities of a few days or weeks, issued by banks mainly to corporate customers that have idle funds on which they wish to receive a return until needed for other purposes.

During 1965, a number of banks began to issue short-term promissory notes in circumstances that, in the Board's judgment, resulted in avoidance of laws and regulations governing payment of interest on deposits and maintenance of reserves against deposits, particularly our Regulations Q (12 CFR 217) and D (12CFR 204).

For this reason, on January 26, 1966, the Board published a Notice of Proposed Rule Making that would affect the status of short-term promissory notes under Regulations D and Q (31 Federal Register 1010). The proposed amendment to those regulations, a copy of which is enclosed, would define the term "deposit" to include promissory notes to the extent indicated therein. If the amendment is adopted, such promissory notes payable on demand or with an original maturity of less than 30 days would constitute "demand deposits" as defined in section 217.1(a) of Regulation Q. Since the twelfth paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 371a) and section 217.2(a) of Regulation Q forbid member banks "directly or indirectly, by any device whatsoever, /to/ pay any interest on any deposit which is payable on demand", it would be unlawful for a member bank thereafter to issue interest-bearing promissory notes, covered by the definition, that were payable within less than 30 days. Such promissory notes with maturities of 30 days or more would be subject to the maximum rate of interest applicable to time deposits under the Supplement to Regulation Q, which is 5-1/2 per cent per annum at the present time.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

Item No. 10
2/9/66

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 10, 1966.

Dear Sir:

The Board is considering whether member banks should be permitted to compound interest on deposits at the maximum permissible rate more frequently than the quarter-year intervals now permitted under Regulation Q.

Enclosed is a draft Notice of Proposed Rule Making with respect to permitting member banks to pay interest on deposits at the maximum permissible rate compounded on any basis that the member bank may desire to adopt.

Before publishing the proposal for public comment, the Board would like to have the benefit of your views on the matter. It would be appreciated if your comments could be received by March 4, 1966.

Very truly yours,

Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

DRAFT

FEDERAL RESERVE SYSTEM

[12 CFR Part 217]

[Reg. Q]

PAYMENT ON INTEREST ON DEPOSITS

Notice of Proposed Rule Making

The Board of Governors is considering amending § 217.6 (the Supplement to Regulation Q) to permit member banks to compound interest on deposits on any basis - quarterly, monthly, daily, or continuously - at the maximum permissible rate. Under the present regulation, interest may be compounded on any basis a member bank may desire to adopt, but the amount of interest so compounded may not exceed the amount of interest at the maximum permissible rate when compounded quarterly. As amended, § 217.6 would read as follows:

"§ 217.6 Maximum rates of interest payable on time and savings deposits by member banks.

"Pursuant to the provisions of section 19 of the Federal Reserve Act and § 217.3, the Board of Governors of the Federal Reserve System hereby prescribes the following maximum rates 1/ of interest payable by member banks of the Federal Reserve System on time and savings deposits:

1/ The maximum rates of interest payable by member banks of the Federal Reserve System on time and savings deposits as prescribed herein are not applicable to any deposit that is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia.

"(a) Maximum rate on time deposits. - No member bank shall pay interest on any time deposit at a rate in excess of 5-1/2 per cent per annum.

"(b) Maximum rate on savings deposits. - No member bank shall pay interest on any savings deposit at a rate in excess of 4 per cent per annum.

"In calculating the rate of interest paid, the effects of compounding of interest shall be disregarded."

The purpose of the proposed amendment is to permit member banks greater flexibility in contracting and in operations with respect to interest on deposits. Its adoption would have an insignificant quantitative effect on the maximum permissible interest that member banks may pay for the use of funds.

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. 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 , 1966.

Dated at Washington, D. C., this day of , 1966.

By order of the Board of Governors.

Merritt Sherman,
Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 11
2/9/66

OFFICE OF THE CHAIRMAN

February 10, 1966.

The Honorable Henry H. Fowler,
Secretary of the Treasury,
Washington, D. C. 20220

Dear Joe:

As you know, the Comptroller of the Currency has taken the position that a proposal by The Chase Manhattan Bank (National Association) to acquire the stock of Liberty Bank and Trust Company of Buffalo is legally permissible provided the approval of the Comptroller is obtained under the Bank Merger Act of 1960. In the Board's opinion there are serious questions as to (1) whether the proposed transaction is legally permissible under provisions of the National Bank Act and (2) if so, whether the transaction is subject to the Bank Merger Act. Since this transaction, if "approved" by the Comptroller and consummated, would have important implications for the banking structure of the country, it would seem highly desirable, if possible, to obtain an opinion of the Attorney General of the United States with respect to these questions.

Section 5136 of the Revised Statutes (12 U.S.C. 24) prohibits national banks from purchasing corporate stocks except as permitted by law, and this prohibition is made applicable also to State member banks of the Federal Reserve System. As long ago as 1933, the Federal Reserve Board ruled that under these provisions of law a State member bank is prohibited from purchasing stock in another bank (1933 Federal Reserve Bulletin 449). With particular reference to Chase's proposal, the Board last November advised Chase that it appeared to the Board that its acquisition of the stock of Liberty National Bank and Trust Company would violate the stock-purchase prohibition of section 5136 of the Revised Statutes. At the same time, the Board also advised Chase that the transaction appeared to violate the provisions of section 5155 of the Revised Statutes (12 U.S.C. 36), regarding the establishment of branches by national banks.

Whether or not the transaction is legally permissible in view of the above-mentioned provisions of law, it is the Board's view that the proposed transaction is not subject to the Bank Merger Act of 1960, and it is understood that Chairman Randall of the Federal

Deposit Insurance Corporation has expressed the same view in a letter to the Comptroller. The legislative history of the Bank Merger Act clearly indicated that it was not to apply to stock acquisitions. The Supreme Court of the United States, in U. S. v. Philadelphia National Bank, 374 U.S. 321 (1963), stated that "the Bank Merger Act applies only to mergers, consolidations, acquisitions of assets, and assumptions of liabilities but not to outright stock acquisitions".

If the Bank Merger Act were applicable, as the Comptroller contends, to transactions of this kind, a national bank's acquisition of the stock of more than one bank (or of even one bank, under a bill that has passed the House of Representatives) would require the Comptroller's approval under the Bank Merger Act and also the approval of the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956; and it is obvious that such a situation not only would involve unnecessary and burdensome duplication of regulation and control, but it could easily result in conflicting decisions by the two supervisory agencies on the same case. It seems clear that Congress intended stock acquisitions of banks to be controlled by the Holding Company Act rather than the Merger Act.

If Chase, with the approval of the Comptroller of the Currency, purportedly given under the Bank Merger Act, should consummate the proposed transaction by acquiring the stock of Liberty National Bank and Trust Company, it is unlikely that any one would thereafter challenge the legality of the transaction. In the absence of any such challenge, it is inevitable that other national banks would similarly seek to take over other banks through acquisition of their stock. Such transactions, in our opinion, would clearly run counter to the policy of Congress with respect to both stock acquisition by national banks and the establishment of branches by national banks.

For these reasons, it seems important to obtain, before the consummation of the transaction proposed by Chase, the opinion of the Attorney General with respect to (1) the legality of the transaction under section 5136 and section 5155 of the Revised Statutes, and (2) if determined to be legally permissible, whether the Bank Merger Act is applicable to such transaction.

Your cooperation in obtaining such an opinion of the Attorney General would be deeply appreciated.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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

Item No. 12
2/9/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 9, 1966

Mr. Leland M. Ross, Vice President,
Federal Reserve Bank of Chicago,
Chicago, Illinois. 60690

Dear Mr. Ross:

In accordance with the request contained in your letter of February 4, 1966, the Board approves the appointment of Miss Bonnie Jeane Gray as an assistant examiner for the Federal Reserve Bank of Chicago. Please advise the effective date of the appointment.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.