Minutes for April 21, 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 _____

Gov. Robertson _____

Gov. Shepardson _____

Gov. Mitchell _____

Gov. Daane _____

Gov. Maisel _____

Gov. Brimmer _____

Minutes of the Board of Governors of the Federal Reserve System on Thursday, April 21, 1966. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Robertson, Vice Chairman
Mr. Shepardson
Mr. Maisel
Mr. Brimmer

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
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. Shay, Assistant General Counsel
Mr. Axilrod, Associate Adviser, Division of Research and Statistics
Mr. Hersey, Adviser, Division of International Finance
Mr. Leavitt, Assistant Director, Division of Examinations
Mrs. Semia, Technical Assistant, Office of the Secretary
Messrs. Forrestal and Heyde of the Legal Division
Mr. Eckert, Chief, Banking Section, Division of Research and Statistics
Messrs. Gemmill and Grimwood of the Division of International Finance
Messrs. Egertson and Maguire and Miss McShane of the Division of Examinations
Mr. Veenstra, Chief, Financial Statistics Section, Division of Data Processing

Approved letters. The following letters were approved unanimously after consideration of background information that had been made available to the Board. Copies of the letters are attached under the item numbers indicated.

	Item No.
Letter to The Reading Trust Company, Reading, Pennsylvania, waiving the requirement of six months' notice of withdrawal from membership in the Federal Reserve System.	1
Letters to Wells Fargo Bank, San Francisco, California, approving the establishment of branches (1) at Bay and High Streets, Santa Cruz, and (2) in the Olympia Plaza Shopping Center, Seaside.	2-3
Letter to City Trust Company, Bridgeport, Connecticut, approving the establishment of a branch at Route 6 and Payne Road, Danbury.	4

Report on competitive factors. There had been distributed a draft of report to the Comptroller of the Currency on the competitive factors involved in the proposed merger of Bank of Chesapeake, Chesapeake, Virginia, into First & Merchants National Bank, Richmond, Virginia.

Governor Brimmer referred to certain passages in the draft report that appeared to be mutually inconsistent in describing the degree to which communities in the Norfolk-Portsmouth metropolitan area were accessible to each other, and it was understood that appropriate changes would be made.

Governor Robertson expressed disagreement with the conclusion that the overall effect of the proposal on competition would not be significantly adverse. The bank to be merged was not a small one, and it was the only locally-headquartered bank in Chesapeake. Even though merger of a smaller bank by a large one might not result in a substantial

increase in the overall size of the large bank, every time such a merger was approved banking concentration was increased, and in Virginia the trend toward concentration had been rapid in the past 5 years. Moreover, even though Bank of Chesapeake had a low ratio of loans to deposits, that did not necessarily mean that the needs of the community were going unserved, because there were a number of other sources of credit available. Some competition would be eliminated, along with the potential for much more competition. Even if the majority of the Board favored the report as drafted, he thought it would be well to point out in the conclusion that the merger would eliminate the only bank with headquarters in Chesapeake.

The other members of the Board agreed with that change, but expressed the view that the proposed conclusion was warranted.

After further discussion the report was approved for transmittal to the Comptroller, Governor Robertson dissenting, with appropriate clarifying changes in the text to cover the point Governor Brimmer had made. The conclusion of the report in the form in which it was transmitted read as follows:

> While some competition exists between First & Merchants National Bank, Richmond, and Bank of Chesapeake, numerous alternative banking facilities will remain in the area upon consummation of the proposed merger. The transaction would eliminate the only locally headquartered bank in Chesapeake and extend First & Merchants National Bank's geographic coverage into two additional cities in the Norfolk-Portsmouth metropolitan area, but would not result in the bank having an undue portion of such area's deposits.

The overall effect of the proposal on competition would not be significantly adverse.

Governor Shepardson observed, in connection with the discussion of channels of communication among the communities involved in this case, that maps should be useful as an aid to appraisal of geographical relationships in many situations.

Mr. Solomon responded that the Division of Examinations would plan to include maps with its presentation of matters involving complex geographical relationships. The maps would be intended to facilitate the Board's consideration in the case of competitive factor reports; they would not necessarily have to be transmitted with such reports.

Interest rate surveys. There had been distributed a memorandum dated April 15, 1966, in which the Division of Research and Statistics described recommended changes in the quarterly survey of interest rates on business loans. After comments on the nature and purpose of the survey, the memorandum discussed the changes contemplated, including substitution of a three-way maturity classification of loans for the present two-way breakdown, the exclusion of loans to foreign businesses and of business instalment loans of a type similar to consumer instalment loans, a request that respondents specify whether the stated interest rate was applied on a discount or an accrual basis, changes in the reporting period, weighting procedures, and publication format, and expansion of the size of the sample. It was noted that even with the recommended improvements the survey would not provide an adequate measure of

interest rates on term loans, and that a System subcommittee had been directed to make a study of possible means of providing the information needed in that area.

After introductory comments by Mr. Eckert, Governor Shepardson asked whether, if the loan categories being eliminated provided information that had been considered of value, it might be possible to combine reporting of such data with some of the categories that were recommended for the revised survey form. Mr. Eckert responded that System staff had concluded that a separate survey would be desirable to cover business instalment loans. Since changes in rates on such loans were relatively infrequent, quarterly reporting seemed unnecessary. Moreover, such loans were usually not made through the business loan department of a bank but through the consumer instalment loan department. Therefore, it had seemed advisable to organize a separate series that could have simpler requirements and could be tailored to bank administrative practices.

Governor Brimmer inquired as to when such a series could be instituted, and after staff responses he expressed the view that it would be desirable to push forward on the project because it was important to know more about the credit experience of small businesses. The staff commented that the need for information was recognized, and that a subcommittee was being set up to explore ways of obtaining meaningful information, particularly from medium and small sized banks.

Governor Brimmer then referred to an indication by the staff that, although foreign loans were being eliminated from the quarterly

survey, useful information might be obtained from data gathered by the Treasury Department regarding commitments for foreign loans. He expressed reservations as to whether a commitment series would be as useful as a loan series; while he did not wish to contest the staff findings in this respect, he would be interested in knowing more about the reasoning underlying its conclusion. It was indicated that such information would be supplied.

Governor Shepardson commented on the apparent need for following up the survey made in December 1965 in regard to rates of interest on time and savings deposits. In the ensuing discussion the staff reported on study by System committees looking toward the initiation of a new series, and several members of the Board expressed the view that efforts in that direction should be expedited. The question of updating the December survey also was discussed, and a view was expressed that it would be particularly desirable if current information could be obtained and analyzed before midyear. In response to questions as to the time needed for a new survey, the staff indicated that the period required for presenting the results of the December survey probably could be shortened; it might be possible to complete a follow-up study in about six weeks.

Several members of the Board urged that work on such a survey be pressed forward as rapidly as possible. Governor Maisel, however, indicated that he had reservations, on the grounds that a one-time survey

quickly became obsolete and a statistical series providing continuing information on savings flows would be more significant. It was understood that he and Governor Brimmer would discuss the matter further with the staff and that a recommendation would be placed before the Board.

The recommended changes in the quarterly interest rate survey were then approved unanimously.

Messrs. Axilrod, Eckert, and Veenstra then withdrew from the meeting.

Application of State Bank and Trust Company. There had been distributed a memorandum from the Division of Examinations dated April 15, 1966, with other pertinent papers, regarding the application of The State Bank and Trust Company, Defiance, Ohio, to merge The Ney State Bank, Ney, Ohio. The Division recommended approval, as had the Federal Reserve Bank of Cleveland.

After summary comments by Mr. Egertson based on the distributed material, all members of the Board expressed themselves in favor of the proposal.

The application was thereupon approved unanimously, with the understanding that an order and statement would be drafted for the Board's consideration. It was pointed out, in this connection, that the banks concerned had not begun publication of notice of the proposal until about a week ago, although their attention had been called to this requirement; therefore, the Board's decision could not be issued until completion of the required period of public notice.

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

Export-Import Bank program (Items 5 and 6). In a conference on April 6, 1966, President Harold F. Linder and other representatives of the Export-Import Bank of Washington discussed with members of the Board and its staff certain questions in relation to a proposed program directed toward minimizing any financing obstacles that might hamper exports. Some of the questions related to the discount function of the Federal Reserve, and others with the possibility of a lending facility within the Bank where commercial banks could discount export paper.

In a letter of April 13 the Bank referred to the fact that in January 1966 the Board had determined that participation certificates with respect to which the Bank unconditionally guaranteed the payment of principal and interest when due were eligible as collateral for advances by the Federal Reserve Banks to member banks. The Bank now asked that the Board also find eligible as collateral the obligations arising from three additional types of transactions, as described in the letter.

At the meeting of the Board on April 20 there was preliminary discussion of the eligibility question, on the basis of recommendations in a distributed memorandum from the Legal Division dated April 19 and a draft of reply to Executive Vice President Rowntree of the Export-Import Bank. The draft reply would take the position that the first category of obligations about which the Bank had inquired would be

eligible as collateral but, for reasons stated, the other two categories of obligations would not be eligible. Action was deferred in order that Board consideration of the matter might include the reply to be made regarding the other points raised during the April 6 conference. There had now been distributed a draft of reply to President Linder that would express sympathy with the Bank's program for buttressing export credit facilities and would attach a memorandum of comments by the Board's staff regarding the proposed rediscount facility.

At the beginning of today's discussion Governor Robertson indicated that he and Governor Brimmer had met with the staff to review the proposed reply to President Linder and that the draft documents distributed prior to this meeting reflected the results of such review.

Governor Maisel referred to the statement at the beginning of the staff comments proposed to be sent to President Linder, namely, that any proposal for creation of a rediscount facility should meet two conditions: (1) it should not hamper overall monetary policy, and (2) it should contribute to improvement in the U.S. payments position in the immediate future. In his view the objective of the facility was not clear. As it stood, the proposal seemed to have only a very limited objective, and he had misgivings as to whether it would be worth while. Rather than reply to the Export-Import Bank in this context, he believed it would be preferable first to determine the longer-term goals.

After comments by Governor Brimmer regarding the background against which the program had been developed, Governor Maisel reiterated

his doubts about dealing on an ad hoc basis with an immediate problem through creation of a facility whose existence might have long-term implications for monetary policy. Consideration should be given to what kind of facility would work best over the longer run as an instrument for dealing with the basic problem.

Governors Brimmer and Robertson then commented further on the background of the program, noting among other things that the Administration, following a high-level study, wanted to insure that lack of adequate financing would not be an obstacle to exports in the current year and had asked the Export-Import Bank to work out a program. It had been hoped that other Government agencies having an interest in the field would provide technical assistance to the extent possible in helping the Bank to work out this mechanism. In that context, it seemed inadvisable to refuse to respond to the points raised by the Bank on the ground that fundamental questions about financing facilities must first be analyzed. Moreover, there was some urgency for responding to the request as soon as possible, since the Export-Import Bank intended to announce its program shortly. Even though there might be some misgivings, it should be borne in mind that the program was the Bank's and not the Federal Reserve's.

Governor Shepardson commented that while he would not object to going ahead in the manner proposed, he agreed with Governor Maisel that facilities created to deal with an immediate problem often tended to

become entrenched. According to the data he had seen, it seemed questionable whether the availability of export credit was an acute problem.

Governor Robertson replied that a matter of strategy was involved to some extent. While he doubted that the proposed rediscount facility would be used substantially, its availability would help to answer allegations to the effect that export possibilities were being lost because of obstacles to financing.

After further discussion the letters to President Linder (with attached memorandum of comments by the Board's staff) and to Executive Vice President Rowntree were approved for transmittal in the forms attached as Items 5 and 6, Governor Maisel's reservations being noted. It was understood that copies of the letters would be sent to the Federal Reserve Banks for their information.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following items:

Telegram to the Federal Reserve Bank of Minneapolis (attached Item No. 7) approving the appointment of Larry Gene Ammann as assistant examiner.

Memorandum from Royal Shipp, Economist, Division of Research and Statistics, requesting permission to teach a course in Mortgage Financing at American University.

Secretary

Item No. 1
4/21/66

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 21, 1966

Board of Directors,
The Reading Trust Company,
Reading, Pennsylvania.

Gentlemen:

The Federal Reserve Bank of Philadelphia has forwarded to the Board of Governors a letter dated April 12, 1966, signed by President Fred R. Davis, together with the accompanying resolution, signifying your intention to withdraw from membership in the Federal Reserve System and requesting waiver of the six months' notice of such withdrawal.

The Board of Governors waives the requirement of six months' notice of withdrawal. Under the provisions of 208.10(c) of the Board's Regulation H, your institution may accomplish termination of its membership at any time within eight months from the date that notice of intention to withdraw from membership was given. Upon surrender to the Federal Reserve Bank of Philadelphia of the Federal Reserve Bank stock issued to your institution, such stock will be cancelled and appropriate refund will be made thereon.

It is requested that the certificate of membership be returned to the Federal Reserve Bank of Philadelphia.

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. 2
4/21/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 21, 1966

Board of Directors,
Wells Fargo Bank,
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Wells Fargo Bank, San Francisco, California, of a branch in the vicinity of the intersection of Bay Street and High Street, Santa Cruz, 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.)

Item No. 3
4/21/66

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 21, 1966

Board of Directors,
Wells Fargo Bank,
San Francisco, California.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Wells Fargo Bank, San Francisco, California, of a branch in the Olympia Plaza Shopping Center, located on Fremont Boulevard between Echo and Phoenix Avenues, Seaside, California, 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. 4
4/21/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 21, 1966

Board of Directors,
City Trust Company,
Bridgeport, Connecticut.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by City Trust Company, Bridgeport, Connecticut, of a branch at the intersection of Route 6 and Payne Road, Danbury, Connecticut, 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

Item No. 5
4/21/66

OFFICE OF THE VICE CHAIRMAN

April 21, 1966

The Honorable Harold F. Linder,
President,
Export-Import Bank of Washington,
Washington, D. C. 20571.

Dear Harold:

The Board and its staff have given intensive consideration to the various suggestions concerning export credit assistance that you put forward in your meeting with Chairman Martin and myself last April 6.

The Board fully endorses the basic principle that export sales ought not to be lost because of a lack of financing. We are in sympathy with the program for buttressing export credit facilities that you sketched in your comments at the April 6 meeting and that was outlined in somewhat greater detail in the memorandum you left with us. While there are some particular points on which we would suggest further consideration or modification in the light of other public policies, market practices or technical requirements of law, we believe the general approach you have outlined is well worth pursuing.

Subsequent to our meeting, Mr. Rowntree, Executive Vice President of the Export-Import Bank, addressed a letter dated April 13, 1966, to Mr. Sammons of the Board's staff, formally requesting that obligations arising from three categories of transactions mentioned in your April 6 memorandum be declared eligible as collateral security for advances by Federal Reserve Banks to member banks. Our staff specialists have reviewed the matter, and a reply is being addressed to Mr. Rowntree specifying what could and could not be done in this respect under current law. A copy of that letter to Mr. Rowntree is enclosed.

In addition, we asked our staff to review the other points raised in your April 6 memorandum, dealing with various aspects of a possible lending facility within the Export-Import Bank where commercial banks could discount export paper. A memorandum summarizing the comments of our staff on that subject is also enclosed.

If we, or members of our staff, can be of any further service to you in these respects, please do not hesitate to call upon us. This is a matter in which both our agencies have an important stake, and we would like to be of whatever constructive assistance we can.

Sincerely,

(Signed) J. L. Robertson

J. L. Robertson

Enclosures 2

April 21, 1966.

Staff Comments on
Export-Import Bank Memo of
April 6, 1966

General Comments

Any proposal for creation of an Ex-Im rediscount facility should meet two conditions:

(1) It should not hamper overall monetary policy.

(2) It should contribute to improvement in the U.S. payments position in the immediate future.

A rediscount facility in the Ex-Im Bank could readily be designed so that it would not contribute to creation of bank reserves. While some redistribution of reserves within the banking system would result from rediscounting--in the direction of improving the relative position of banks with export paper in their portfolios--this would, of course, be an objective of establishing the facility.

In order to contribute immediately to improvement in the U.S. payments position, an Ex-Im rediscount facility would have to generate an increase in exports greater than the expansion of outstanding credits to foreigners directly or indirectly related to the rediscounting facility.

Because the purpose of creating the facility would be to enable the banks to extend credits over and above those they would otherwise grant, it must be assumed that some increase in credits

outstanding would occur. However, any expansion of outstanding foreign credits (or, in fact, any portfolio adjustment that enabled a bank to reduce its outstanding foreign credits by less than it otherwise would have planned to do) would be an offset to the increased exports insofar as the U.S. balance of payments position was concerned. Procedures would need to be established to insure that the banks did not unload on the Ex-Im a large part of their existing holdings of export paper and make new credits to foreigners on a substantial scale--credits that they were previously not prepared to make either because of their liquidity position or because of their position under the VFCR.

Any rediscount procedure adopted should be consistent with the VFCR Program; i.e., the rediscount facility should not provide the commercial banks an opportunity to relieve any pressure which might be applied by the target ceiling. If the rediscount is made with recourse to the commercial bank the transaction should be treated as a borrowing and the asset should remain on the bank's books--and within the ceiling. If the procedure were expanded to include actual purchase of the paper by the Ex-Im, and if large scale sales developed, it might become necessary to make downward adjustments in the VFCR targets, but that problem can be dealt with if it should arise.

The following comments refer to the numbered paragraphs of the memorandum.

1. Eligibility as collateral security for advances by Federal Reserve Banks of paper guaranteed by Ex-Im or insured by FCIA is discussed in a letter to Mr. Rowntree dated April 21, 1966.

2. Whether to include guaranteed or insured paper in the proposed Ex-Im rediscount facility would seem to be a matter for Ex-Im decision. From our point of view, we see no substantive issue involved.

3. Since rediscounts by the Ex-Im would not create bank reserves and would be entirely separate from the extension of the definition of eligible paper for advances by Federal Reserve Banks proposed in paragraph 1, the suggested procedure would pose no problems for the Federal Reserve that would be appreciably different from those resulting from any other increase in U.S. Government lending, such as loans to savings and loan associations by Federal Home Loan Banks. It would open to the banks a new source of funds; the extent to which it would be used would depend on the terms and conditions for such borrowing compared with those available on funds from other sources.

4. Since the purpose of the suggested procedure is to encourage bank financing of U.S. exports, and since the immediate benefit of increased exports on the U.S. balance of payments will

depend on increased cash payments for U.S. exports, it would be desirable to keep the maturity terms of export paper as short as possible. This might be encouraged by keeping the term of Ex-Im rediscounts relatively short.

In the cases of rediscount without recourse described in paragraphs 8 and 9 of the Ex-Im Bank memorandum, there would seem to be no reason for the Ex-Im Bank's not holding the paper for its remaining life. If the rediscounting bank were given an option to repurchase, it could then take back the paper if interest rates declined. The instrument could be made more flexible, and unnecessary long-term rediscounting discouraged, by varying the posted rates according to maturity of the credit.

The Ex-Im might consider reselling purchased paper in the market, after adding its guarantee. This device would tend to reduce dependence on Treasury financing.

5. If the rediscount took the form of an outright purchase, the rate might well be the same as on Ex-Im participation certificates. But consideration might be given to varying the rate as a means of influencing the volume of paper presented for discount. This would help to avoid rationing of the credit, on the one hand, or large swings in the volume of rediscounts, which might be undesirable, on the other.

If the rediscount took the form of a loan against collateral, as proposed in paragraph 3 of the Ex-Im Bank memorandum, the rate might depend upon the establishment of criteria to insure that the facility would not be used as an alternate source of funds for purposes other than export financing. If this could be assured, a somewhat lower rate than that charged on purchases might be appropriate in order to encourage the banks to use the facility.

6. The rate on the underlying export paper might be relevant if a principal purpose is to stimulate banks to make export credits at relatively low interest rates. In this case a maximum limit on the rate on eligible paper could be fixed. However, this would be hard to enforce, since the banks could acquire paper with a low coupon rate, but at a discount.

7. Assuming that the function of the rediscount facility would be to enable the banks to expand export credits by easing the burden of such credits on their liquidity position, it would be reasonable to permit banks to rediscount a certain percentage of all export paper over and above the level outstanding on a base date.

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

Item No. 6
4/21/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 21, 1966

Mr. R. H. Rowntree,
Executive Vice President,
Export-Import Bank of Washington,
Washington, D. C. 20571

Dear Mr. Rowntree:

This is in reply to your letter of April 13, 1966, to Mr. Sammons of the Board's staff, requesting that certain obligations carrying Eximbank's guarantee and acquired by financial institutions in the manner hereinafter described be declared eligible as security for advances by Federal Reserve Banks to member banks under the provisions of section 13 of the Federal Reserve Act. The three categories of transactions in which these obligations are acquired are described in your letter as follows:

"1. In the first type of transaction, Eximbank fully guarantees a direct loan made by a financial institution to a foreign buyer to finance exports from the United States. These transactions (frequently called financial guarantees) usually involve longer than medium term credit, and Eximbank's guarantee to the financial institution is unconditional.

"2. In the second type of case, a bank finances a specific medium term export credit sale by buying a fixed percentage of the foreign purchaser's obligation without recourse on the American exporter. The financed portion of such a credit sale is evidenced by a promissory note which is issued by the foreign buyer to the order of the exporter who in turn endorses the note to the financial institution without recourse. The financial institution purchases a fixed percentage of the note -- usually 90%. Eximbank's guarantee to the financial institution covers 100% of the financial institution's participation in the note if a default is caused by political events and 100% of the 'later installments' of the financial institution's participation without any condition whatsoever. The financial institution assumes the risk of commercial default on the 'early installments.' (The terms 'early

installments' and 'later installments' are specifically defined in each case. Later installments normally are those falling due after the first 18 months of the note.)

"3. In the third category are obligations insured under a short or medium term comprehensive export credit insurance policy issued by Eximbank and the Foreign Credit Insurance Association (FCIA), which consists of about 75 private insurance companies. Eximbank acts as a co-insurer with FCIA as well as reinsurer in respect of losses which exceed certain specified amounts."

Advances to member banks by Federal Reserve Banks are made pursuant to the provisions of the eighth paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 347) which provides, in part, that "any Federal reserve bank may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for . . . purchase by Federal reserve banks under the provisions of this Act." (Emphasis added.)

Section 14(b) of the Federal Reserve Act (12 U.S.C. 355) provides that a Federal Reserve Bank may purchase "any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest . . .".

Applying these statutory provisions to the factual situations which you presented, the Board has concluded that notes involved in the first type of transaction would be eligible as security for advances provided that Eximbank fully guarantees the obligation and that such guarantee is general, unconditional, and fully transferable by and to the Reserve Bank receiving the guaranteed obligation as collateral to an advance. That is, the unconditional guarantee must extend to any holder of the obligation, and not only to the Federal Reserve Bank. It is assumed, of course, that the obligations themselves will also be transferable by and to the Reserve Banks.

Notes in the second type of transaction would not be eligible as security for advances because the obligations there involved are not "fully guaranteed" by the United States. However, if the promissory note issued by the foreign buyer were divided into two parts, one representing the portion which is fully and unconditionally guaranteed in all respects by Eximbank, and the other representing the unguaranteed part, the fully guaranteed note would be eligible as security for advances provided that the guarantee meets the requirements specified

above for the guarantees issued with respect to obligations described in the first situation.

The obligations described in the third category would not be eligible as security for advances since the Foreign Credit Insurance Association is not a government agency and its insurance, or guarantee, is not a guarantee of the United States Government.

Your letter further states that if the Board finds that Eximbank's guarantee or insurance in the foregoing cases is not adequate, Eximbank is prepared to issue to the Federal Reserve Bank which accepts such obligations as collateral an unconditional guarantee to pay in the event of default of such obligations. It is the Board's view that such an arrangement would not comply with the provisions of sections 13 and 14(b) of the Federal Reserve Act. A special guarantee separately given to the Reserve Bank would not constitute a full and unconditional guarantee of the "obligation" itself by Eximbank. Moreover, section 14(b) of the Federal Reserve Act covers guaranteed obligations that may be bought and sold by Reserve Banks; and, in the Board's opinion, this means that the obligations must be fully marketable. An obligation which contains a guarantee only for the benefit of the Federal Reserve Bank would not be fully marketable, and, consequently, would not be eligible for purchase. Therefore, such obligations would not be eligible as security for advances. As previously mentioned, however, if the guarantee of the note itself were made general, unconditional and fully transferable to any holder, the obligations would be eligible as security for advances under section 13.

Any obligations which would be considered eligible as security for advances in accordance with the conclusions expressed herein should be in such form as to be readily identifiable by the Reserve Banks as obligations fully and unconditionally guaranteed by Eximbank.

The Board, of course, does not intend that the conclusions expressed herein be construed in any way as changing the operation of the discount facility administered by the Federal Reserve Banks.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Item No. 7
4/21/66

TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

April 21, 1966.

GALUSHA - MINNEAPOLIS

Reurlet April 19, 1966, Board approves appointment of Larry Gene Ammann as assistant examiner for Federal Reserve Bank of Minneapolis, effective today.

(Signed) Elizabeth L. Carmichael

CARMICHAEL