

Minutes for May 19, 1966

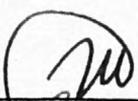
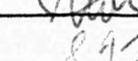
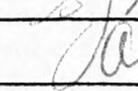
To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin	<u></u>
Gov. Robertson	<u></u>
Gov. Shepardson	<u></u>
Gov. Mitchell	<u></u>
Gov. Daane	<u></u>
Gov. Maisel	<u></u>
Gov. Brimmer	<u></u>

Minutes of the Board of Governors of the Federal Reserve System
on Thursday, May 19, 1966. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, 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. Hexter, Associate General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Koch, Deputy Director, Division of Research
and Statistics
Mr. Partee, Associate Director, Division of
Research and Statistics
Mr. Williams, Adviser, Division of Research and
Statistics
Mr. Axilrod, Associate Adviser, Division of
Research and Statistics
Mr. Gramley, Associate Adviser, Division of
Research and Statistics
Mr. Sammons, Associate Director, Division of
International Finance
Mr. Leavitt, Assistant Director, Division of
Examinations
Miss Wolcott, Technical Assistant, Office of
the Secretary
Mr. Forrestal, Senior Attorney, Legal Division
Messrs. Eckert, Ettin, Fisher, Gehman, Keir,
Rosenblatt, and Trueblood of the Division
of Research and Statistics
Messrs. Burton, Egertson, Kline, and Poundstone
of the Division of Examinations

Approved items. The following items were approved unanimously
after consideration of background information that had been made

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available to the Board. Copies are attached under the respective numbers indicated.

	<u>Item No.</u>
Letter to Security Trust Company of Rochester, Rochester, New York, approving the establishment of a branch in the Town of Irondequoit and commenting on the bank's capital position.	1
Letter to The Provident Bank, Cincinnati, Ohio, approving an extension of time to establish a branch at Vine and Seventh Streets coincident with the relocation of the bank's main office.	2
Letter to The Company for Investing Abroad, Philadelphia, Pennsylvania, granting permission to purchase shares of Greyhound Financial and Leasing Corporation A. G., Zug, Switzerland.	3
Telegram to the Federal Reserve Agent at Minneapolis authorizing the issuance to Bancorporation of Montana, Great Falls, Montana, of a general voting permit covering its stock of (1) Central Bank of Montana, Great Falls, Montana, (2) Citizens Bank of Montana, Havre, Montana, and (3) Liberty Bank of Montana, Chester, Montana.	4
Letter to the Chairman of the House Committee on Ways and Means reporting favorably on H.R. 11257, a bill relating to income tax treatment of distributions by companies that might become subject to the Bank Holding Company Act of 1956 by reason of enactment of H.R. 7371.	5

With respect to Item No. 3, it was understood, pursuant to Vice Chairman Robertson's suggestion, that Mr. Sammons would check into certain circumstances surrounding this investment in terms of applicant's adherence to the guidelines of the voluntary foreign credit restraint

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program. The question related to the fact that applicant's parent bank had agreed to make available to the Swiss corporation a commitment to issue standby letters of credit up to \$2 million to guarantee payment of the corporation's short-term obligations. Mr. Sammons subsequently arranged for the Federal Reserve Bank of Philadelphia to be in touch with applicant and its parent bank to make sure they understood the application of the guidelines to this kind of situation, particularly if the standby letters of credit were drawn upon.

Ruling on "hypothecated deposits" (Items 6 and 7). There had been distributed a memorandum dated May 13, 1966, from the Legal Division relating to a request from the Federal Reserve Bank of Cleveland that the Board review its unpublished 1928 ruling requiring member banks to maintain reserves, in accordance with Regulation D, Reserves of Member Banks, against so-called "hypothecated deposits" created by payments on instalment loans.

In reviewing the memorandum, Mr. Forrestal pointed out that this ruling posed a problem for member banks in a few States, including Ohio and Texas, where by law the books of commercial banks showed as "deposits" the funds paid by a borrower on an instalment loan until the loan was paid in full. When banks received a payment on such a loan, the outstanding amount of the loan was not reduced; rather, the payment was held by the bank until the sum accumulated was sufficient to repay the entire amount of principal and interest, at which time appropriate

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accounting entries were made to eliminate the loan and the deposit account. In the meantime, the bank commingled the funds with its other cash assets, but it did not pay any interest on the hypothecated accounts. The contracts between the banks and their customers were drafted in such a way as to insure that the funds in the accounts could not be reached by the "depositors" or third parties. The benefit the banks derived from this procedure was that interest could be collected in advance and the payments spread over a specific number of months, thus permitting a greater rate of return than the rate of simple interest permissible under State law.

While most other States had laws permitting commercial banks to obtain the same return on instalment loans as that permitted in Ohio, they did not require payments on the loans to be carried on the banks' books as deposits.

The legal question involved was whether the payments were deposits for purposes of Regulation D. The Cleveland Bank argued that to qualify as deposits, funds must be placed with a bank and the person placing such funds must have the right to withdraw them. The funds in question, however, were commingled with other cash assets and were not used immediately to reduce the amount of debt. Consequently, they might be regarded as payments. On the other hand, the term "deposits" could be more widely interpreted, as in the Federal

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Deposit Insurance Act where they were defined in part as "funds held as security for an obligation due to banks or others. . .". The Board, of course, had authority under section 19 of the Federal Reserve Act to define demand, time, and savings deposits for purposes of reserve requirements, and it had previously held these hypothecated funds to be deposits.

The Legal Division now recommended that the Board reverse its 1928 ruling (and certain subsequent interpretations) and declare that funds placed in a bank clearly beyond the reach of the borrower and third parties were not deposits regardless of the terms used in relevant State statutes or in the bank's accounting procedures and, therefore, were not subject to the reserve requirements of Regulation D. A draft of letter to the Federal Reserve Bank of Cleveland reflected this recommendation.

The Legal Division further recommended that the interpretation be published in the Federal Register and in the Federal Reserve Bulletin.

At the conclusion of Mr. Forrestal's summary, Mr. Hackley stated that he was in complete agreement with the recommendation. It seemed to him the significant factor was that the bank had no obligation or liability to repay these funds.

Mr. Koch noted that there was the question whether reversal of the 1928 ruling might result in more widespread use of the device, with resultant distortion of consumer credit statistics and, in some

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cases, possible evasion of State usury laws. In final analysis, however, the Research Division felt there was little or no justification from the economic or monetary policy point of view for continuing the previous ruling. Consequently, he agreed with the recommendation of the Legal Division.

Mr. Solomon also indicated agreement with the recommendation, noting that the proposed reversal would eliminate an inequity, in certain States, between member and nonmember banks and between banks and nonbank lenders.

In the ensuing discussion members of the Board explored a number of questions directly and indirectly related to the problem under consideration, including the effective rates of return on instalment loans in Ohio and other States, the extent to which member banks in Ohio and other States having similar laws were subjected to higher reserve requirements on the basis of "real" deposits, the possibility of encouraging avoidance of State usury laws, bookkeeping mechanics involved in the "hypothecated deposits" plan, and similarities and dissimilarities between the use of these "deposits" and the technique of requiring compensating balances.

At the conclusion of the discussion the recommendation of the Legal Division was approved, Governor Mitchell dissenting, along with the letter to the Federal Reserve Bank of Cleveland (copy in the form approved attached as Item No. 6), with the understanding that an

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interpretation based thereon would be published in the Federal Register. Attached as Item No. 7 is a copy of a letter sent to the Federal Reserve Banks in this regard.

Governor Mitchell, in dissenting, noted that the issue was a relatively minor one, centered primarily in one or two States, whereas a reversal of the Board's earlier position might tend to encourage a spreading use of the device, through adaptation of compensating balance practices, in order to avoid the impact of reserve requirements. He also observed that this was not the time to be releasing reserves.

Application of Baystate Corporation (Items 8 and 9). There had been distributed drafts of an order and statement reflecting the Board's approval on April 13, 1966, of the application of Baystate Corporation, Boston, Massachusetts, to acquire shares of Lynn Safe Deposit and Trust Company, Lynn, Massachusetts.

The issuance of the order and statement was authorized. Copies of the documents, as issued, are attached as Items 8 and 9.

Messrs. Burton, Egertson, Kline, and Poundstone then withdrew from the meeting.

Recommendations of Home Builders Association. Governor Brimmer brought to the attention of the Board a letter to Chairman Martin dated May 16, 1966, from Mr. Larry Blackmon, President of the National Association of Home Builders, with which Mr. Blackmon enclosed copies of a letter to the President of May 12 and various other papers expressing the Association's concern about "a most serious problem with respect

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to mortgage credit and the home building industry of the United States." Certain recommendations were made with respect to actions that might be taken, both in the area of monetary policy and otherwise, to alleviate the situation.

Governor Brimmer said he understood that the letter to the President was receiving attention in certain other agencies. The letter to the Board requested comments, and it might be that some response should be made as a matter of courtesy. However, agencies within the Executive Branch would no doubt be responding to the President about the points in the May 12 letter that were within their purview.

Governor Maisel noted that he had attended a meeting of certain Government officials with Mr. Blackmon. He had sent to the other members of the Board a memorandum of that meeting, and he would be sending them today a memorandum of a meeting he had yesterday with Mr. Duesenberry of the Council of Economic Advisers and Mr. Sternlight of the Treasury at which the discussion ranged over the problems and possible policies raised by restricted flows of money to savings and loan associations and the mortgage market. Without doubt, he said, this area was hit harder by a restrictive monetary policy than other sectors of the economy. The Board's reaction, he thought, almost had to be one of agreeing that there was a problem, and that it was up to the Administration and the Congress to do something about the problem if they wanted. He agreed with the view that the position of the Home Builders

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Association was basically one of special pleading. But the Association was right in the sense that if a restrictive monetary policy was used, this was one of the costs.

Preparation for hearings. By way of general preparation for the House Banking and Currency Committee hearings on H.R. 14026, a bill to prohibit issuance by insured banks of negotiable certificates of deposits and other similar negotiable instruments, and H.R. 14422, a bill to prohibit insured banks from issuing time deposits in denominations of less than \$15,000, a staff economic and financial review was presented. Mr. Gehman spoke on production and prices, Mr. Trueblood on GNP and the labor market, Mr. Keir on savings flows, and Mr. Fisher on mortgage market and construction activity. It was understood that copies of their statements would be distributed to the members of the Board to augment the supporting charts and tables distributed at this meeting.

There ensued a general discussion during which it was understood that a revised draft of statement to be presented before the Committee by Vice Chairman Robertson, on behalf of the Board, next Tuesday would be prepared by the staff after the scope of Secretary Fowler's testimony today had become known, the draft then to be reviewed by the Board. (The Secretary was expected to include in his testimony a proposal for an amendment to the law that would authorize the imposition of lower interest rate ceilings on the portions of time and savings deposits that were under the maximum amount eligible for deposit insurance.)

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The Vice Chairman also expressed the view that there would appear no need, in the light of developments, for the Board to send a letter to the Committee Chairman reporting on H.R. 14026 and H.R. 14422, since the Board's position would be made known in the statement presented next Tuesday, and there was general agreement with this view.

In the course of the discussion Governor Shepardson reported that following the Board meeting on Tuesday, and after talking long distance with Chairman Martin, he (Governor Shepardson) called Under Secretary of the Treasury Barr and told him that (1) the Board had no objection to a revision of the hearing schedule whereby Secretary Fowler would appear on May 19, the date formerly set for the Board; (2) the Board would not offer objection to the Treasury proposal, as presented to the Board, nor would it take a position of sponsoring the proposal; and (3) the Board was not committing itself, if the amendment should be enacted, as to any form of implementation of the authority. Under Secretary Barr, he said, agreed that this was an appropriate position for the Board to take.

Governor Brimmer said that in conversations with Under Secretary Barr and Mr. Sternlight he had indicated that although the Board had adopted essentially a neutral position with respect to the Treasury proposal, he was quite certain that individual Board members, if asked at the hearing, might well express a view that the proposed amendment

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was not the best way in which to deal with the problem and that they would prefer alternatives, which they might or might not specify. The fact that the Board was not opposing the proposal did not mean that individual members would necessarily remain silent and fail to express their personal views.

Governor Shepardson stated that he had also called to Mr. Barr's attention the fact that the proposed amendment, in the form presented to the Board, appeared to indicate that the lower interest rate would apply to the total amount of time deposits of \$10,000 or over. Mr. Barr, he said, stated that this was not the intent and that the proposal would be amended to make the lower rate applicable only to the insured portion of a deposit.

Foreign travel. Mr. Reynolds, Adviser in the Division of International Finance, was authorized to travel to Paris, France, to attend a meeting of Working Party 2 of the OECD, to be held on May 25-27, 1966, with per diem at the rates prescribed in the Standardized Government Travel Regulations.

Composition of delegations. Earlier this year Chairman Martin accepted on behalf of the Federal Reserve System an invitation from President Elizalde of the Central Bank of the Argentine Republic to send a delegation to participate in the Eighth Meeting of Technicians of Central Banks of the American Continent and the Ninth Operating Meeting of CEMLA, which would be held in Buenos Aires in November 1966.

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Mr. Sammons, in a memorandum dated May 16, 1966, now recommended that the composition of the delegations be as follows: (1) for the Technicians' Meeting--three representatives of the Board, including, as head of the delegation, the Director or Associate Director of the Division of International Finance, and three Bank representatives (one each from the Federal Reserve Banks of New York, San Francisco, and Cleveland); and (2) for the Operating Meeting--the Director or Associate Director of the Division of International Finance as head of the delegation, two representatives from the Federal Reserve Bank of New York, and one each from the Federal Reserve Banks of Dallas and Minneapolis.

Following discussion, agreement was expressed with the recommended composition of the delegations.

The meeting then adjourned.

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

Appointments, effective the respective dates of entrance upon duty

Division of Personnel Administration

<u>Name and title</u>	<u>Basic annual salary</u>
Frances Eva Burton, Clerk-Typist	\$3,814
Ladonia Ann Dressler, Stenographer	4,149
Diane Dzik, Stenographer	4,149
Susan K. Huffman, Stenographer	4,797
Vickie Mae Hulteen, Stenographer	4,149

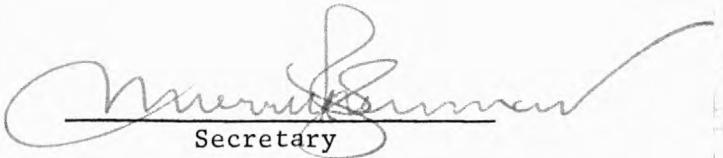
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Appointments, effective the respective
dates of entrance upon duty (continued)

Division of Personnel Administration

<u>Name and title</u>	<u>Basic annual salary</u>
Donna Ann Jameson, Clerk-Typist	\$3,814
Suzanne Marie MacDonald, Stenographer	4,797
Lynn Marie Ottem, Stenographer	4,149
Sudie Gay Phillips, Stenographer	4,149
Patricia Ann Russell, Stenographer	4,149
Barbara Jane Sawyer, Stenographer	4,149
Nancy Lee White, Stenographer	4,149


Secretary

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 1
5/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 19, 1966



Board of Directors,
Security Trust Company
of Rochester,
Rochester, New York.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Security Trust Company of Rochester, Rochester, New York of a branch in Stutson Bridge Plaza, located approximately 750 feet east of the intersection of Pattonwood Drive and Thomas Avenue, Town of Irondequoit (unincorporated area) Monroe County, New York, provided the branch is established within six months from the date of this letter.

The Board notes that the most recent examination of your bank reveals a somewhat less than satisfactory capital position and concurs in the Reserve Bank's suggestion that consideration be given to the raising of additional capital funds.

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.)

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

Item No. 2

5/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 19, 1966



Board of Directors,
The Provident Bank,
Cincinnati, Ohio.

Gentlemen:

The Board of Governors of the Federal Reserve System extends to December 27, 1967, the time within which The Provident Bank, Cincinnati, Ohio, may establish a branch at the southeast corner of Vine and Seventh Streets, Cincinnati, Ohio, coincident with the relocation of The Provident Bank's main office from that location to the southeast corner of Vine and Fourth Streets, Cincinnati, Ohio.

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. 3
5/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 19, 1966.



The Company for Investing Abroad,
Fidelity-Philadelphia Trust Building,
Philadelphia, Pennsylvania. 19109

Gentlemen:

As requested in your letter of April 27, 1966, the Board of Governors grants consent for your Corporation to purchase and hold 272 Class "B" shares of Greyhound Financial and Leasing Corporation A.G. ("GAG"), Zug, Switzerland, at a cost of approximately US\$326,400, provided such stock is acquired within one year from the date of this letter. In this connection, the Board also approves the purchase and holding of such shares in excess of 10 per cent of your Corporation's capital and surplus.

The foregoing consent is being given with the understanding that the investment now being approved, combined with other foreign loans and investments of your Corporation and Fidelity-Philadelphia Trust Company 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. The Board considers that compliance with the priorities expressed in Guideline 4 would require that total nonexport credits to developed countries in Continental Western Europe not exceed the amount of such loans and investments as of the end of 1965, unless this can be done without inhibiting the bank's ability to meet all reasonable requests for priority credits within the over-all target.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

T E L E G R A M
LEASED WIRE SERVICEBOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTONItem No. 4
5/19/66

May 19, 1966.

BEMIS - MINNEAPOLIS

KEBJE

- A. Bancorporation of Montana, Great Falls, Montana
- B. Central Bank of Montana, Great Falls, Montana
Citizens Bank of Montana, Havre, Montana
Liberty Bank of Montana, Chester, Montana
- C. Prior to issuance of permit authorized herein, Applicant shall execute and deliver to you, in duplicate, an agreement in form accompanying Board's letter S-964 (F.R.L.S. #7190).

(Signed) Karl E. Bakke

BAKKE

Definition of KEBJE

The Board authorizes the issuance of a general voting permit, under the provisions of section 5144 of the Revised Statutes of the United States, to the holding company affiliate named below after the letter "A", entitling such organization to vote the stock which it owns or controls of the bank(s) named below after the letter "B" at all meetings of shareholders of such bank(s), subject to the condition(s) stated below after the letter "C". The period within which a permit may be issued pursuant to this authorization is limited to thirty days from the date of this telegram unless an extension of time is granted by the Board. Please proceed in accordance with the instructions contained in the Board's letter of March 10, 1947, (S-964).

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 5
5/19/66

OFFICE OF THE VICE CHAIRMAN

May 19, 1966



The Honorable Wilbur D. Mills,
Chairman,
Committee on Ways and Means,
House of Representatives,
Washington, D. C. 20515

Dear Mr. Chairman:

This is in reply to Mr. Irwin's letter of May 12, 1966, concerning H.R. 11257, relating to distributions by companies that may become subject to the Bank Holding Company Act of 1956 by reason of enactment of H.R. 7371.

The Bank Holding Company Act of 1956 prohibits any bank holding company from engaging in any nonbanking business or acquiring more than 5 per cent of the voting shares of any such business, and requires bank holding companies to divest any such interests previously acquired. As enacted in 1956, the Act includes provisions designed to make sure that those who are forced to dispose of property because of this divestiture requirement will not suffer unfavorable tax consequences. The Board believes that this same principle should apply to divestitures required as a result of the amendments now under consideration.

While we are not competent to comment on the technicalities of H.R. 11257, we understand that it has been drafted by the Office of Legislative Counsel of the House of Representatives in consultation with the Treasury Department with the objective of providing for holding companies covered by the pending amendments tax treatment similar to that provided in 1956. On this basis, we hope that your Committee will be able to act promptly and favorably on H.R. 11257.

Sincerely,

(Signed) J. L. Robertson

J. L. Robertson.

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

Item No. 6
5/19/66



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 25, 1966

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

Dear Mr. Hickman:

This is in reply to your letter of December 3, 1965, requesting the Board to re-examine its 1928 ruling that member banks must maintain reserves, in accordance with Regulation D, against hypothecated "deposits" created by payments on installment loans.

It is understood that in Ohio, where a majority of these accounts are held, the books of commercial banks show as "deposits" the funds that are paid by a borrower on an installment loan, until the loan is paid in full. The amounts received are not immediately used to reduce the unpaid balance due on the note, but are held by the bank until the sum of the payments equals the entire amount of principal and interest. It is further understood that the banks commingle the funds received in repayment of such installment loans with their other cash assets, but do not pay any interest on these hypothecated accounts. The contracts between certain banks in Ohio and their customers are drafted in such a way as to insure that the funds in the accounts cannot be reached by the depositor or third parties. According to the material submitted with your letter, Section 1115.10 of the Ohio Revised Code requires payments on installment loans to be denominated as "deposits" if interest at the maximum rate permitted by law is to be collected in advance, and payments on the full amount of the loan are to be made over a predetermined number of months.

In 1928, the Board first ruled that member banks must maintain reserves against such hypothecated deposits. An interpretation to that effect was published in 1931 (1931 Fed. Res. Bull. 538), and the Board has continued to adhere to that position.

The Board has reconsidered its earlier rulings and has decided that where the agreement between the bank and borrower is

Mr. W. Braddock Hickman

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such that installment payments on loans are irrevocably assigned to the bank and cannot be reached by the depositor or his creditors, such payments are not "deposits" regardless of the terms used in relevant State statutes or in the bank's books and records and, therefore, are not subject to the reserve requirements of Regulation D.

The Board's earlier rulings on this subject are superseded to the extent that they conflict with the conclusion expressed herein.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 7

5/19/66

S-1994



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

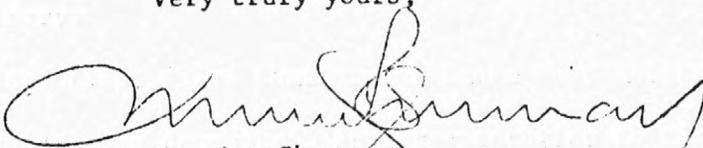
May 25, 1966.

Dear Sir:

Enclosed is a copy of an interpretation of the Board regarding reserves against funds received by member banks in connection with instalment loans. This interpretation will be published shortly in the Federal Register and the Federal Reserve Bulletin; however, it is assumed that the Reserve Banks concerned will wish to send copies of the interpretation to member banks for their information at once.

The interpretation is to be applied effective with reserve computation periods beginning June 9, 1966.

Very truly yours,


Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

Reserves Against Funds Received by Member Banks
in Connection with Instalment Loans

The Board of Governors has been asked to re-examine its 1928 ruling that member banks must maintain reserves, in accordance with Federal Reserve Regulation D (12 CFR 204), against hypothecated "deposits" created by payments on instalment loans.

It appears that in some States the books of commercial banks show as "deposits" the funds that are paid by a borrower on an instalment loan, until the loan is paid in full. The amounts received are not immediately used to reduce the unpaid balance due on the note, but are held by the bank until the sum of the payments equals the entire amount of principal and interest. It is understood that under the terms of the agreement between the banks and their customers the funds so received are assigned to the bank and cannot be reached by the borrower or his creditors.

In 1928, the Board first ruled that member banks must maintain reserves against such hypothecated deposits. An interpretation to that effect was published in 1931 (1931 Fed. Res. Bulletin 538), and the Board has continued to adhere to that position.

The Board has reconsidered its earlier rulings and has decided that where the agreement between the bank and borrower is such that instalment payments on loans are irrevocably assigned to the bank and cannot be reached by the borrower or his creditors, such payments are not "deposits" regardless of the terms used in relevant State statutes or in the bank's books and records and, therefore, are not subject to the reserve requirements of Regulation D.

The Board's earlier rulings on this subject are superseded to the extent that they conflict with the conclusion expressed herein.

Board of Governors of the
Federal Reserve System.

May 25, 1966.

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C.

In the Matter of the Application of
BAYSTATE CORPORATION,
BOSTON, MASSACHUSETTS,
for approval of the acquisition of
voting shares of Lynn Safe Deposit
and Trust Company, Lynn, Massachusetts.

ORDER APPROVING APPLICATION
UNDER BANK HOLDING COMPANY ACT

There has come before the Board of Governors, pursuant to section 3(a)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(a)(2)) and section 222.4(a)(2) of Federal Reserve Regulation Y (12 CFR 222.4(a)(2)), an application by Baystate Corporation, Boston, Massachusetts, a registered bank holding company, for the Board's prior approval of the acquisition of up to 100 per cent of the outstanding voting shares of Lynn Safe Deposit and Trust Company, Lynn, Massachusetts.

As required by section 3(b) of the Act, notice of receipt of the application was given to, and views and recommendation requested of, the Commissioner of Banks for the State of Massachusetts.

The Commissioner advised the Board that, pursuant to State law, a petition had been filed by Applicant with the Massachusetts Board of Bank Incorporation for prior approval of the proposed acquisition, and a hearing would be held thereon. The Massachusetts Board subsequently approved the acquisition, and the Board of Governors was so notified.

Notice of receipt of the application was published in the Federal Register on January 28, 1966 (31 Federal Register 1167), providing an opportunity for interested persons to submit comments and views with respect to the proposed acquisition. The time for filing such comments and views has expired, and all those received have been considered by the Board.

IT IS HEREBY ORDERED, for the reasons set forth in the Board's Statement of this date, that said application be and hereby is approved, provided that the acquisition so approved shall not be consummated (a) within seven calendar days after the date of this Order or (b) later than three months after said date.

Dated at Washington, D. C., this 19th day of May, 1966.

By order of the Board of Governors.

Voting for this action: Chairman Martin, and
Governors Shepardson, Mitchell, Daane, Maisel, and Brimmer.

Absent and not voting: Governor Robertson.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

(SEAL)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Item No. 9
5/19/66

APPLICATION BY BAYSTATE CORPORATION, BOSTON, MASSACHUSETTS,
FOR APPROVAL OF THE ACQUISITION OF VOTING SHARES OF
LYNN SAFE DEPOSIT AND TRUST COMPANY, LYNN, MASSACHUSETTS

STATEMENT

Baystate Corporation, Boston, Massachusetts ("Applicant"), a registered bank holding company, has applied to the Board of Governors under the Bank Holding Company Act of 1956 ("the Act"), for permission to acquire up to 100 per cent of the outstanding voting shares of Lynn Safe Deposit and Trust Company, Lynn, Massachusetts ("Bank"). Applicant's bank holding company system is comprised of ten subsidiary banks which, at June 30, 1965,^{1/} operated 130 banking offices and held deposits of about \$650 million. Acquisition of Bank would add one banking office to Applicant's system and about \$6 million in deposits.

Views and recommendation of supervisory authority. - As required by section 3(b) of the Act, the Board notified the Commissioner of Banks for the State of Massachusetts of receipt of the application and requested his views and recommendation thereon. The Commissioner replied that, pursuant to State law, a petition had also been filed

^{1/} Unless otherwise indicated, all banking data noted are as of this date.

by Applicant for a hearing before the Massachusetts Board of Bank Incorporation with respect to the same matter. The Massachusetts Board subsequently approved the acquisition, and the Board of Governors was so notified.

Statutory factors. - Section 3(c) of the Act requires the Board to take into consideration the following five factors: (1) the financial history and condition of the holding company and the banks concerned; (2) their prospects; (3) the character of their management; (4) the convenience, needs, and welfare of the communities and the area concerned; and (5) whether or not the effect of the proposed acquisition would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

Financial history and condition, prospects, and management of Applicant and Bank. - The financial history and condition of Applicant are satisfactory, its prospects appear favorable, and its management is regarded as capable and experienced. These conclusions are based in part on the sound financial history and condition and the satisfactory deposit and earnings growth evidenced with respect to Applicant's subsidiary banks.

Bank, chartered in 1887, also has a history of sound operations and good earnings, and its present condition and prospects are regarded as satisfactory. Bank's management is competent and

experienced, although somewhat conservative as evidenced by Bank's relatively slow deposit growth in recent years. Applicant asserts that Bank is faced with a management succession problem in that none of Bank's present staff is qualified to replace the president and another senior officer, who are, respectively, 60 and 59 years of age. Any problem with respect to management succession is made less immediate by the fact that the two officers mentioned have agreed to remain with the bank for a least another 18 months, assuming approval of Applicant's proposal. Thus Applicant's proposed assistance with respect to providing qualified first and second line management, while consistent with approval of the application, offers little affirmative basis therefor.

Convenience, needs, and welfare of the communities and area concerned. - Bank's primary service area, from which it derives about 84 per cent of its deposits of individuals, partnerships, and corporations ("IPC deposits"), consists of the City of Lynn and the adjoining town of Swampscott. The 1965 population of this area was nearly 107,000. Lynn, which is about 11 miles northeast of Boston, is highly industrialized. Nearly 23,000 persons are employed by some 200 manufacturing firms in Lynn, the largest of which is General Electric Company. In addition, nearly 800 wholesale and retail trade outlets in the city employ more than 7,000 persons. Swampscott, about two miles east-northeast of Lynn, is primarily a residential suburb and summer resort with limited commercial and industrial development.

A large number of Swampscott residents work in Boston and daily travel some thirteen miles between the two locations. Swampscott is characterized by Applicant as a rather stable community with a large number of relatively high income families.

The record in this matter fails to establish that there are presently any unserved major banking needs in Bank's service area, nor is it contended that Bank, operating as a subsidiary of Applicant, will provide services that are not presently available through it and the other banks serving the area. Rather, the thrust of Applicant's proposal is to furnish for or make available to Bank, as Applicant states it has done for its present subsidiary banks, a number of operating and management services, chief among which are data processing, investment analysis, and administration of group life insurance, pension, and profit-sharing plans. Applicant asserts that the proposed services will result in more aggressive operational policies within Bank with the expectation that Bank will become a stronger competitor within its trade area, and thus help improve generally the quantity and quality of banking services therein. It is reasonably concluded that Applicant's proposed assistance will aid Bank in making more efficient its own operations, thus ultimately affording improved services to its customers.

As to Applicant's proposal to make available through Bank certain direct customer services, the principal such service would be the referral by Bank of certain credit demands, asserted by

Applicant not usually met by commercial banks, to a small business investment corporation which is wholly owned by nine of Applicant's ten subsidiary banks. While the prospect of this credit rendition is a consideration weighing somewhat toward approval of the application, the fact is that the volume of loan business presently being handled by this small business investment subsidiary is so relatively small as compared with the loan business done by Applicant's banks that its contribution to Bank's lending ability appears minimal.

On the basis of the evidence presented bearing on the convenience, needs, and welfare of the communities and area involved, the Board concludes that such evidence is consistent with approval of the application.

Effect of proposed acquisition on adequate and sound banking, the public interest, and banking competition. - Applicant's ten subsidiary banks operate 18 per cent of the State's commercial banking offices and hold about 10 per cent of the deposits of such commercial banks; comparable percentages with respect to commercial and mutual savings banks in the State are 13 and 4, respectively. The two bank holding companies operating in Massachusetts control about 21 per cent of the commercial bank deposits and nine per cent of all bank deposits in the State.

Bank is located in Essex County and under State law is not permitted to establish branches outside that county. Its deposits (\$5 million of IPC deposits and \$6 million of total deposits) account

for less than two per cent of the IPC and total deposits held by the 24 commercial banks in the county, and only about one-half of one per cent of such deposits held by the 47 commercial and mutual savings banks located there. Applicant presently has two subsidiary banks in Essex County, operating 21 per cent of the county's commercial banking offices and 14 per cent of the offices of all banks. The two subsidiary banks hold about 11 per cent of the IPC and total deposits of commercial banks, and three per cent of such deposits of all banks, located in the county. Approximately seven per cent of the IPC and total deposits of commercial banks, and two per cent of such deposits of all banks, located in the county are held by a subsidiary of Shawmut Association, Inc., the State's other registered bank holding company. Because of the relatively small size of Bank, and in view of the large number of alternative banking sources available, including the 23 savings banks located in the county that hold in the aggregate over twice the total deposits held by all commercial banks, the acquisition of Bank by Applicant would not, in the Board's judgment, result in an undue concentration of banking resources under the control of Applicant's holding company system in either Essex County or the State of Massachusetts. A similar conclusion applies with respect to Bank's primary service area (wherein there are presently no subsidiaries of bank holding companies) inasmuch as Bank's IPC and total deposits constitute only about seven per cent of such deposits of

commercial banks and only about two per cent of such deposits of all banks headquartered in that area.

The offices of Applicant's subsidiaries which are nearest to Bank are the main office and a branch of Beverly Trust Company situated, respectively, nine miles and five miles from Bank. There are a number of offices of other banks located in the areas separating Bank from these two offices, and the intervening areas appear to be heavily populated. These two offices of Beverly Trust Company combined derive only about \$60,000 of IPC deposits, or about one per cent of their total IPC deposits, from Bank's primary service area. As before noted, Bank derives only about 16 per cent of its IPC deposits from all areas outside its primary service area. Thus, in view of the generally local nature of Bank's business, the small amount of deposits which Applicant's banks presently derive from Bank's primary service area, and the large number of alternative outlets available in the area concerned, the Board concludes that there would be no significant competition eliminated or foreclosed as a result of consummation of this proposal.

As to the probable effect of Applicant's proposal on the competitive position of other banks serving the area, within Bank's service area it is in direct competition with the following banking offices: six offices of Essex County Bank and Trust Company, with \$48 million of deposits; three offices of Security-Danvers National Bank, with \$38 million of deposits; one office of North Shore Bank and Banking Company,

a \$3 million institution which was formerly a Morris Plan Bank;^{2/} and a total of five offices of two mutual savings banks each of which bank has deposits in excess of \$90 million. Thus, within its primary service area, bank competes with four substantially larger banks, and one smaller bank with limited lending activities. Applicant's subsidiary banks located in Essex County, with deposits of \$30 million and \$12 million, respectively, are each smaller in terms of total deposits than four of the five competing banks located in Bank's primary service area; and the only banking institution situated in that service area which is smaller than Bank and also smaller than each of Applicant's Essex County subsidiaries is not competing generally for all types of business as are the other banking institutions.

On the basis of the foregoing, it is the Board's opinion that Applicant's acquisition of Bank will not adversely affect the position of any of the other banks located and competing in the Lynn-Swampscott area. Rather, in view of the apparent lack of aggressiveness evidenced by Bank's failure to increase significantly its deposit size in recent years, it is reasonably concluded that Bank's operation under Applicant's control may provide an element of increased competition that will benefit Bank and its present and prospective customers.

^{2/} This bank's operations are limited in that, although it holds both demand and time deposits, it engages only in instalment lending.

Consideration has also been given to the probable effect of Applicant's acquisition of Bank on correspondent bank relationships that potentially could be affected by the acquisition. Applicant has no subsidiary bank situated in Boston to which business from its subsidiaries, principally credit overlines, might be directed. Consequently, the institutions competing with Bank in its primary service area would have no reason to shift correspondent accounts in Boston to avoid giving business to an affiliate of a local competitor, nor would Bank's customers be relegated to but a single source of correspondent bank service. It appears to the Board that consummation of Applicant's proposal will have no measurable impact on existing correspondent bank relationships.

In the light of the foregoing considerations and all the facts in the record, the Board concludes that consummation of the subject proposal would not increase Applicant's size or extent beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

On the basis of the entire record before the Board, and in the light of the factors set forth in section 3(c) of the Act, it is the Board's judgment that the proposed acquisition would be consistent with the public interest and that the application should therefore be approved.

May 19, 1966.