Minutes for June 7, 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 Tuesday, June 7, 1966. The Board met in the Board Room at 2:30 p.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Bakke, Assistant Secretary
Mr. Young, Senior Adviser to the Board and Director, Division of International Finance
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
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. 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
Messrs. Eckert and Ettin of the Division of Research and Statistics

Mr. Joseph W. Barr, Under Secretary of the Treasury

Comment by Mr. Barr. At the invitation of Chairman Martin, Mr. Barr reported his impression of the House Banking and Currency Committee's stand on various legislative proposals concerning certificates of deposit, based upon the course of discussion incident to his appearance before that Committee this morning.

In his opinion, while the Committee evidenced concern about the competition for deposits between savings and loan institutions and commercial banks, there seemed to be considerable confusion among its members about what would be a reasonable solution to the problem. In light of this division of feeling, it was his judgment that the Committee would probably not be able to agree on a bill for report to the floor of the House.

He also reviewed the substance of the testimony he had given before the Committee, noting that he had taken the position that whatever might be done in the direction of legislation aimed at bank time deposits, the regulatory provisions should be temporary in nature and the Board should have broad administrative discretion, especially with respect to any provision regarding reserve requirements.

After responding to certain questions asked by Board members, Mr. Barr withdrew from the meeting.

Certificates of deposit (Item No. 1). At the Board meeting on June 6, 1966, consideration had been given to a proposed response to identical letters of May 31 to each Board member from Chairman Patman of the House Banking and Currency Committee asking certain questions with respect to current legislative proposals to impose restrictions upon issuance of certificates of deposit by banks.

In addition to the draft response and other related materials that had been distributed to the Board before the June 6 discussion,

there had now been distributed the following: letter from the New York Clearing House Association to Chairman Patman dated June 6, 1966, commenting on H.R. 14026 and related bills; and a memorandum from Mr. Cardon dated June 7, 1966, relating to a question, raised by Congressman Ottinger at the House Banking and Currency Committee hearings on May 24, whether the Board would be disposed to regulate issuance of consumer-type certificates of deposit by banks should it be given discretionary authority to do so. Also distributed at the beginning of the meeting were: a memorandum of June 6 from Governor Robertson setting forth his views on appropriate actions for the Board to take in restraining issuance of certificates of deposit by banks, and a draft of proposed amendments to Regulation Q (Payment of Interest on Deposits) and Regulation D (Reserves of Member Banks) from Mr. Hackley, dated June 3, 1966, that would increase reserve requirements to 6 per cent on time deposits in excess of $5 million and set a maximum rate of interest of 3 per cent on time deposits with a maturity of less than 90 days.

In commenting upon Chairman Patman's May 31 letter, Governor Robertson stated that he could not subscribe to a response favoring establishment of rate differentials on certificates of deposit based upon amount, and reiterated his firm conviction that any such differential should be premised upon differences in maturity of the instruments.

Governor Mitchell observed that the problem with which the Board was now faced had emergency aspects, and there were members of

the Board who felt, on the other hand, that the immediate situation called for a rate differentiation based on amount of the deposit. In this connection, Governor Maisel also recalled that he had stated, in recent testimony before the House Banking and Currency Committee, that the size test might be worth exploring, although the Board would be reluctant to see such a provision imposed because of the inherent discrimination against small depositors that would be involved.

Governor Robertson acknowledged these points, but observed that his viewpoint represented a conviction regarding the most desirable regulatory approach from a long-run standpoint, and he was opposed to compromising this principle for short-run expediency.

Governor Daane expressed accord with the idea of having differences in maturity as the normal basis for establishing different rates of interest on time deposits, but added that it would also be desirable, in his opinion, for the Board to have standby authority to use the deposit-size test under circumstances where the maturity test was not an effective regulatory mechanism. He believed the response to Chairman Patman should stress this point but question whether $100,000 was an appropriate line of demarcation for this purpose.

There followed discussion whether reference to a particular deposit amount would be advisable if rate differentials on this basis should be endorsed. Governor Robertson took the position that it would be unfortunate if any deposit size were to be incorporated in rate

differential authority, because this would reduce the Board's discretionary flexibility in future use of the authority if needed. Governor Shepardson, on the other hand, stated the view that since Congress was pressing for the deposit-size differential in interest rates, the point at which the distinction would take effect should be set by Congress.

Further exchange of opinions developed a consensus that the response to Chairman Patman should contain no reference to amount in connection with comment on the proposal for Board authority to establish different rates of interest on time deposits using the size test. Also, it was agreed that emphasis should be placed upon the view that any authority of this nature was warranted only for use as a temporary expedient, and would be invoked only on this basis. In addition, Chairman Martin expressed the belief that Chairman Patman should be apprised, in one fashion or another, that discretionary authority with respect to the regulatory authority in question was regarded by the Board as implicitly embracing discretion to determine whether or not to invoke the authority, and, in this regard, that the Board did not believe its use at this time would be warranted.

Various other suggestions were made for editorial changes in the text of the draft, following which it was agreed that rather than transmitting the document to Chairman Patman in letter form it would be adapted for use by Chairman Martin as a prepared statement in his appearance before the House Banking and Currency Committee scheduled for the morning of June 8.

The document, in amended form based on the foregoing discussion, was thereupon approved for use as a statement of Board position by the Chairman in his June 8 testimony. A copy is attached as Item No. 1.

Inquiry from Chairman Patman. There had been distributed copies of a letter dated June 6, 1966, from Chairman Patman of the House Banking and Currency Committee requesting that in forthcoming testimony before his Committee the Board's views be made known on proposals to:

1. Increase the range of required reserves on time deposits to 4-10 per cent.

2. Increase the minimum maturity on time deposits from the present 30 days to 90 days.

3. Lower the maximum interest rate payable on time deposits from 5-1/2 per cent to 4-1/2 per cent, but permit renewal of all presently outstanding deposits at the contract rate.

4. Permit open market purchase by the Federal Reserve System of any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any Federal Home Loan Bank.

It was agreed that the Board's position with respect to the first proposal had already been developed; namely, that the Board would favor increased flexibility to set required reserves within a broader range than presently existed.

Insofar as concerned the second proposal, Governor Brimmer noted that its effect would be to require the Board to eliminate funds with maturities of under 90 days from the definition of time deposits,

and this could have far-reaching effect on both interest rate structures and required reserves of member banks. It was agreed that the Board should oppose this provision.

With respect to the third proposal, it was also agreed that opposition should be expressed, consistent with the Board's prior comments concerning proposals to reduce the maximum permissible rate of interest on certificates of deposit.

Concerning the fourth proposal, Chairman Martin suggested an appropriate response would be that the Board had had the subject of direct purchase of Federal agency issues under study, and the tentative conclusion reached was that it was a procedure fraught with dangerous implications.

Governor Daane concurred, observing that if a definitive answer were to be called for at this time, specifically with respect to obligations of the Federal Home Loan Bank System, the response should be unqualified opposition, since he felt that the Treasury Department had ample flexibility under existing legislation to provide that System with operating funds as needed.

There followed discussion of the question whether, apart from the authority Federal Reserve Banks now had to accept certain Federal agency issues as security for discounts or advances, it would be desirable for the System to have direct purchase authority. Governor Mitchell suggested that while there would appear to be no particular

drawback to broadening the scope of agency issues eligible as collateral for discounts or advances, he could see real problems in carrying the Board's authority to the point of engaging in open market transactions in these securities; this was especially true of small issues with thin secondary market appeal.

Mr. Cardon commented that this particular inquiry by Chairman Patman should not be regarded as merely an academic question; that very morning Congressman Reuss, in the course of a House Banking and Currency Committee hearing, had spoken of the direct purchase proposal in terms that suggested an intention to have the System committed to purchase agency issues specified by the Department of Housing and Urban Development and the Treasury Department.

Discussion of this point developed a consensus that any legislative proposal encroaching upon the System's independence in formulation of open market policy would be undesirable, but at this time it would be sufficient to state that the Board had the matter of direct purchase of agency obligations under study, and could see a number of serious problem areas involved. It was agreed that this represented the position of the Board at this time.

It was also agreed that no formal response to Chairman Patman's June 6 letter was called for, since Chairman Martin could express the view of the Board on the questions posed in informal comments during the course of testimony before the House Banking and Currency Committee tomorrow.

Certificates of deposit. Brief consideration was given to the position that might be taken with respect to a question raised by Congressman Ottinger, in the course of hearings by the House Banking and Currency Committee on May 24, whether at the present time the Board would exercise authority to impose discriminatory interest rates on consumer-type certificates of deposit if this authority were to be given.

The tentative conclusion expressed was that, given current circumstances, the Board would not be inclined to do so at this time. However, at Governor Robertson's suggestion, this subject of discussion was deferred for further consideration at an early meeting of the Board.

Request for mortgage market survey. Mr. Holland reported that Mr. Woodlief Thomas, a consultant to the Senate Banking and Currency Committee, had expressed interest in obtaining a copy of the Board's compilation of responses by the Reserve Banks to the Board's request for information on mortgage market conditions.

The request was denied, subject to redetermination at a later date, and Mr. Holland was instructed to advise Mr. Thomas accordingly.

The meeting then adjourned.

Secretary's Notes: Attached as Item No. 2 is a copy of a letter sent today to G-J Corporation, Galesburg, Illinois, granting that corporation a temporary, revokable section 301 determination. The letter was sent pursuant to the authorization given by the Board on December 17, 1965, and reaffirmed at its meeting on January 4, 1966.

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

Appointments

Kenneth P. Weissman as Summer Assistant, Division of International Finance, with basic annual salary at the rate of $5,181, effective the date of entrance upon duty.

Marilyn F. Metzger as Draftsman (Trainee), Division of Data Processing, with basic annual salary at the rate of $4,149, effective the date of entrance upon duty.

Rescission of resignation

Kathryn A. Morisse, Economist, Division of Research and Statistics, whose resignation had previously been accepted as of the close of business June 3, 1966.

Secretary

For release on delivery

Item No. 1
6/7/66

Statement of

William McChesney Martin, Jr., Chairman,

Board of Governors of the Federal Reserve System,

before the

Committee on Banking and Currency

of the

House of Representatives

June 8, 1966

On behalf of all members of the Board, I am making this statement relating principally to the issues raised in your letter of May 31. Let me first assure you that the Board shares the concern of the Committee over the potential problem in the market for mortgages, with attendant effects on home construction.

There are mounting signs of unusual tightness in the mortgage market, although the available statistics do not permit precise measurement of the difficulty of obtaining new home loans or its effect on residential construction. We believe the Congress would be fully justified in taking action to provide a cushion against too sharp a cutback in residential construction. We understand that your Subcommittee on Housing is now considering increasing the Federal National Mortgage Association's purchase authority. Direct injection of funds into the mortgage market through such traditional programs should prove much more effective in softening the impact on residential construction than any of the proposals for additional restrictions on time deposits.

It should be stressed that the difficulties currently faced by both financial institutions and the housing industry reflect, to an important extent, the result of principal reliance on general monetary policies rather than on fiscal actions to restrain the inflationary pressures of a booming economy. In the context of rapidly growing demands for credit, limitation of available credit supplies has been accompanied by higher interest rates on market

securities, which has diverted flows of savings away from all intermediaries and directly into market instruments. Banks, as well as nonbank intermediaries, have felt the pressure of the rise in market rates. As noted in Governor Robertson's testimony of May 24, the growth rate of all financial institutions has slowed since the first of this year.

As a result of this diminution in the flow of savings to financial institutions at a time of rising credit demands, competition among intermediaries has increased. Savers are being offered higher returns for their funds, and new financial instruments have been devised to accommodate their requirements as to size and maturity of financial asset holdings. The small saver, in particular, has been courted by commercial banks and competing institutions, and has had the opportunity of sharing in the larger rewards for thrift.

The Board regards increased competition among financial institutions as a development that has important economic benefits. Over the long run, increased competition contributes to a more efficient functioning of our financial markets and to an improved allocation of real resources, while fostering innovations in financial technology. The development of the negotiable certificate of deposit into an important financial instrument meeting investors' needs, and at the same time channeling funds to productive uses, is a case in point.

In the short run, however, structural shifts in financial flows may take place so rapidly as to generate adjustment problems for individual financial institutions and for the borrowers they finance. This year, in the context of general restraint on credit expansion, the more active competition of banks for savings funds has impinged directly on the flow of savings to some nonbank intermediaries. These institutions, in turn, have curtailed their new commitments of funds to the mortgage market.

Short-run problems that emerge from the heightened competition are most appropriately handled, the Board believes, by temporary solutions designed to facilitate adjustments of the nonbank financial institutions and the mortgage market, rather than by permanent restrictions that tend to freeze existing relationships and to limit competitive freedom. In this respect, the Board welcomed administrative rulings made earlier this year by the Federal Home Loan Bank Board relaxing liquidity requirements for savings and loan associations and increasing the freedom of these institutions to compete with commercial banks for savings. It also welcomes the legislative proposal to increase the funds available to the Federal National Mortgage Association.

It might also be desirable to facilitate gradual adjustments to a changed competitive environment by increasing the scope of the Board's authority to specify the ceiling rates on, and reserves

held against, commercial bank time deposits. For example, the Board would welcome greater flexibility in the extent to which reserve requirements could be used as an effective tool of monetary policy. A change in the statutory range of required reserves for time deposits (other than passbook savings) might be useful; a range of 3 to 10 per cent would give considerably greater flexibility than now exists.

Increased flexibility of this kind could be utilized more effectively if the proposed amendment permitted graduation of reserve requirements by size of bank. Graduated reserve requirements, as the Board has indicated in its past annual reports, would greatly improve the competitive position of small banks. Equivalent requirements also should be extended to all insured commercial banks so that the reserve burden would be shared by all banks enjoying the benefits of deposit insurance.

It would be a serious mistake, however, at this time of great economic uncertainty -- when financial markets are in a taut and nervous state and the course of future events is so largely dependent on Vietnam developments -- to require by law a doubling of reserve requirements against time deposits before the end of 1966. Such a provision would reduce, rather than enhance, the Board's flexibility in meeting changing economic developments and would run the risk of generating much harsher restraint on economic activity than the prevailing situation called for.

Moreover, the Board feels it would be unwise to set the minimum of the requirement range as high as 8 per cent on deposit liabilities of fixed maturity.

On the question of prohibiting shorter maturities for time deposits, the Board sees no merit in setting a minimum as long as a year or even six months. It would unfairly penalize many small banks, especially in some Midwestern States where time deposits are customarily used in place of passbook savings accounts. It would also penalize many investors by depriving them of the choice of a financial asset of proven acceptance. A minimum maturity as long as six months is not needed to effectuate the prohibition of payment of interest on demand deposits.

Prohibiting all shorter term time deposits would force sharp adjustments in money markets. Banks are already paying close to the present 5½ per cent ceiling on 3- to 4-month money in the market for large-denomination CD's. According to our latest CD maturity survey, over 80 per cent of the outstanding large negotiable CD's will mature in the next six months. Thus, with the present ceiling rate of 5½ per cent, a prohibition against issuing CD's of less than six months maturity might cause banks to lose a large portion of these deposits over the next six months. Even with a higher ceiling on longer term CD's, banks might still lose a substantial part of these deposits, because investors may be unwilling to commit funds for as long as six months.

A sudden withdrawal of funds from the CD market would force many banks into sweeping portfolio adjustments, and under present circumstances might create chaotic conditions in the money and capital markets. Assets liquidated by banks would not necessarily be those sought by corporate funds seeking alternatives to CD's. The result might be sharp discontinuities in the supply of funds available to some sectors of the economy. State and local governments, small business borrowers, and home builders and buyers might well be the principal sufferers.

It is clear, therefore, that any proposals intended to limit the range of competition among intermediaries for small savings must be carefully drawn to avoid serious disruption of flows of funds in the well-developed money and capital markets. In this respect, the proposal to distinguish between time deposits according to their size, for purposes of establishing rate ceilings, may be worth considering. Today, large-denomination negotiable CD's and time deposits of smaller denomination sell in relatively distinct markets. Most buyers of large-denomination CD's are very large investors, including nonfinancial corporations, foreign depositors, State and local governments, and pension funds. Small denomination time deposits, on the other hand, serve as a savings medium for individuals, and as an investment medium for small businesses and municipalities.

Legislative authority for the Board to distinguish temporarily between these two markets in setting ceiling rates might in some situations facilitate actions to smooth the transitory adjustment problems of competition for savings funds in smaller amounts without disrupting flows of funds in the money and capital markets. The size of the deposit that divides these two markets cannot be stated precisely, however, and it might be possible to distinguish effectively between them, for purposes of establishing rate ceilings, drawing the line at a deposit size either smaller or larger than $100,000.

The Board believes that the determination of ceiling rates, and differentials in rates, should be left to administrative discretion, thereby permitting adaptation of the ceilings to changing circumstances. Financial market pressures can and do change rapidly; a ceiling rate fixed by law would be much more difficult to adapt to the changing credit needs of the economy. For example, the ceiling rate of 4½ per cent on time deposits under $100,000 suggested in the letter of May 31 from Chairman Patman is far below rates currently available in the money market for such risk-free instruments as U.S. Government and U.S. agency obligations. It is also below the rates available from competing deposit institutions. Such a ceiling would threaten the present and future availability of funds to borrowers heavily dependent on the banking system.

Preliminary indications from a recent survey conducted by the Board indicate that such a ceiling would be injurious to many small banks. By raising their rates to over 4.5 per cent, smaller banks have been able to compete with the money market and other savings institutions. The largest percentage of banks that would suffer serious losses of funds would be those in growing areas of the country -- in States such as Texas, California, Arizona, and others which for many years have had to pay higher rates on deposits in order to attract savings to capital-short areas.

Our survey also shows that banks paying over 4.5 per cent on time deposits other than large negotiable CD's report more than $6.5 billion in deposits of the type which would be restricted by the proposed ceiling. Forcing them to roll back rates offered to the 4.5 per cent level would almost certainly cause them to lose a significant portion of these funds. It would also make it impossible for them to compete effectively in the future. Such a ceiling probably would have the effect of penalizing most the growing and capital-short parts of the country, and the attendant loss of access to credit facilities by small businesses and other borrowers heavily dependent upon these banks might be more serious than the problems the Committee is now seeking to resolve.

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

Item No. 2
6/7/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 7, 1966.

Mr. Wm. R. Wandrey, Vice President,
G-J Corporation,
302 East Main Street,
Galesburg, Illinois. 61401

Dear Mr. Wandrey:

This refers to the request contained in your letter of May 17, 1966, submitted through the Federal Reserve Bank of Chicago, for a determination by the Board of Governors of the Federal Reserve System as to the status of G-J Corporation as a holding company affiliate.

From the information presented, the Board understands that G-J Corporation is a holding company affiliate by reason of the fact that it owns 26,585 of the 37,500 outstanding shares of capital stock of the Bank of Galesburg, Galesburg, Illinois, and that it does not, directly or indirectly, own or control any stock of, or manage or control, any other banking institution.

The Board is in process of reviewing its interpretation of the last paragraph of section 2(c) of the Banking Act of 1933, as amended (12 U.S.C. 221a), as it applies to situations similar to that presented by your request for a determination pursuant to that provision of law. In order to avoid delay that might inconvenience your company, the Board has determined, in accordance with its interpretation of that statutory provision in prior cases of this type, that G-J Corporation is not engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling banks, banking associations, savings banks, or trust companies. Accordingly, G-J Corporation, is not deemed to be a holding company affiliate except for the purposes of section 23A of the Federal Reserve Act (12 U.S.C. 371c) and does not need a voting permit from the Board of Governors in order to vote the bank stock which it owns.

As stated above, the interpretation of section 2(c) is under review by the Board. As a result of that review, it is possible that the Board's interpretation of the statute may be so modified that companies such as G-J Corporation would not be entitled to "favorable" determinations under the last paragraph of section 2(c). In that event, the Board may rescind the determination referred to in the preceding paragraph.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In any event, if the facts should at any time change in such manner as to indicate that G-J Corporation might be so engaged, this matter should again be submitted to the Board for another determination in the light of the new facts. A change in facts would include, among other things, any additional acquisitions of bank stock even though not constituting control.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.