Minutes for August 11, 1966

To: Members of the Board

From: Office of the Secretary

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

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

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

Chm. Martin	WM
Gov. Robertson	R
Gov. Shepardson	CCS
Gov. Mitchell	GLM
Gov. Daane	
Gov. Maisel	SJM
Gov. Brimmer	AFB

Minutes of the Board of Governors of the Federal Reserve System on Thursday, August 11, 1966. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Robertson, Vice Chairman
Mr. Shepardson
Mr. Mitchell
Mr. Daane
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. 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. Farrell, Director, Division of Bank Operations
Mr. Harris, Coordinator of Defense Planning
Mr. Shay, Assistant General Counsel
Mr. Partee, Associate Director, Division of Research and Statistics
Mr. Sigel, Associate Adviser, Division of Research and Statistics
Mr. Sammons, Associate Director, Division of International Finance
Messrs. Hersey, Katz, and Reynolds, Advisers, Division of International Finance
Mr. Kiley, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Kern, Assistant Director, Division of Administrative Services
Mrs. Semia, Technical Assistant, Office of the Secretary
Messrs. Forrestal and Sanders, Senior Attorneys, Legal Division
Mr. Dahl, Chief, Special Studies and Operations Section, Division of International Finance

Mr. Massey, Assistant to the Director, Division of Bank Operations
Messrs. Ring and White, Technical Assistants, Division of Bank Operations
Mr. Egertson, Supervisory Review Examiner, Division of Examinations
Mr. Smith, Assistant to the Director, Division of Administrative Services

Ratification of actions. Actions taken by the available members of the Board at the meeting held on August 10, 1966, as recorded in the minutes of that meeting, were ratified by unanimous vote.

Euro-dollar market. The members of the Board had been furnished copies of an informal memorandum in which the Division of International Finance described certain actions by the Bank of England and related developments in the Euro-dollar market. The Bank of England had reduced quotas assigned by it to British banks for the amount of dollars they might hold as uncovered working balances and as spot cover against forward dollar commitments. In recent months British banks had apparently increased their holdings of dollars for those purposes by substantial amounts and had invested the increase at short term in the Euro-dollar market. It was not a matter of public information what the quotas had been or how much they were reduced, and therefore it was difficult to assess what the impact might be in terms of a flow out of the Euro-dollar market back into British official reserves. The development might tend to dampen the recent sharp increases, as monetary conditions in the United States had tightened, in borrowings in the Euro-dollar market by London branches of American banks to support expansion of their parent banks' lending activity. Sources at a major New York bank that was active in this respect had indicated a belief the Bank of England's move would probably cause curtailment of "Thursday-Friday" transactions, but were not able as yet to assess the potential effect on longer-term Euro-dollar borrowings. However, a more important factor bearing on the ability of U.S. banks to obtain funds in the Euro-dollar market, and the terms available, was the overall position of sterling. A general recovery of confidence in the pound would no doubt generate a much larger return to sterling from Euro-dollars than was to be expected from the recent Bank of England action.

The Division of International Finance commented in supplementation of the distributed material, after which there was a discussion of the reported developments and their implications for the domestic credit situation. Question was raised in particular as to whether it was feasible or desirable to close the loophole by which some U.S. banks were able to obtain through their foreign branches funds to support domestic credit expansion. Mr. Hackley described certain early rulings by the Board that had a bearing upon the situation, and the possibility that a somewhat different position might be supportable now.

At the conclusion of the discussion it was understood that the staff would prepare material not only regarding the legal questions that had been raised, but also regarding aspects of the matter relating to impact on domestic credit and the U.S. balance of payments.

Messrs. Hersey, Katz, Reynolds, and Dahl then withdrew from the meeting.

Application of Union Bank (Item No. 1). Unanimous approval was given to a letter to The Union Bank, Loogootee, Indiana, (copy attached as Item No. 1), granting its request for waiver of the requirement of six months' notice of withdrawal from membership in the Federal Reserve System.

Competitive factor report. A report to the Federal Deposit Insurance Corporation on the competitive factors involved in the proposed merger of Bank of Trade of San Francisco with First San Francisco Bank, both of San Francisco, California, was approved unanimously for transmittal to the Corporation. The conclusion stated that the proposed merger would not have an adverse effect on competition.

Request by Port of New York Authority (Item No. 2). There had been distributed a memorandum dated August 9, 1966, from the Legal Division regarding a request from Counsel for the Port of New York Authority for a copy of a letter of October 23, 1934, from the then Comptroller of the Currency to an investment securities company (J. D. Van Hooser and Company, Lexington, Kentucky). The Authority was a defendant-intervenor in the revenue bond litigation against the Comptroller that had been initiated early in 1966 by a group of investment banking concerns. It had been ascertained that the Office of the Comptroller would not object to the Board's furnishing the parties to the litigation copies of the letter in question. For this and other reasons set out in the memorandum, the Legal Division recommended that the request be granted. A draft response in those terms was attached to the memorandum.

The letter was approved unanimously; a copy is attached as Item No. 2.

> Secretary's Note: Late in 1965 the Board refused a request by Covington & Burling, counsel for the plaintiff in the revenue bond litigation, for the same letter now requested by the Port of New York Authority. Pursuant to an understanding with the staff of the Comptroller that if the request of the Authority were granted the letter would be furnished also to Covington & Burling, a copy was sent to Covington & Burling on August 12, 1966.

Messrs. Shay and Sanders then withdrew from the meeting and Messrs. Johnson, Director, Division of Personnel Administration, Kakalec, Controller, and Byrne, Director, Division of Data Processing, entered the room.

V-loan interest rates (Items 3 and 4). On June 10, 1966, pursuant to action at the meeting on June 3, letters requesting views on a possible increase in the present 6 per cent maximum interest rate on V-loans (loans for defense production purposes guaranteed by various Government procurement agencies) were sent to the 10 guaranteeing agencies and to the Federal Reserve Banks. There had now been distributed a memorandum dated August 8, 1966, in which Mr. Hackley summarized the responses and recommended, for reasons stated in the memorandum, that the Board set a maximum rate of 7-1/2 per cent on V-loans. That rate would be 3 per cent above the present Federal Reserve discount rate, but in deference to a view expressed by the Treasury Department the V-loan rate would not be specifically tied to the discount rate. Prevailing opinion among the guaranteeing agencies had been in favor of a suggestion, which Mr. Hackley also now recommended, that in order that the guaranteeing agencies not share in the increased return on loans, the guarantee fee continue to be computed as though the loan rate was 6 per cent.

The Department of Defense (which had replied on behalf of the several military guaranteeing agencies) had suggested a revision of the schedule of guarantee fees in order to provide "more inducement for lower percentages of guarantee." However, Mr. Hackley doubted, for reasons set out in the memorandum, that such a result would be accomplished. Accordingly, he suggested that before taking action the Board request the views of the nonmilitary guaranteeing agencies. A draft of letter for that purpose was attached to the memorandum. He also suggested the desirability of requesting the views of the Federal Reserve Banks as to the proposed change.

Discussion developed a consensus in favor of a letter to the nonmilitary guaranteeing agencies informing them that the Board was now prepared to increase the maximum rate of interest on V-loans to

7-1/2 per cent, provided, however, that the guarantee fee should continue to be computed as though the loan rate were 6 per cent; and to ask their views as to the revision of the schedule of guarantee fees suggested by the Department of Defense, with an indication that the Board doubted that the revision would accomplish the objective of the Department. The members of the Board also expressed themselves in favor of a letter to the Defense Department containing the same information as the letters to the other agencies, but setting out in more detail the reasons for the Board's reservations as to the suggested revision of the guarantee fee schedule, and inviting the Department's further comments in the light of those reservations.

At the conclusion of the discussion unanimous approval was given to letters in the terms that had been outlined. A copy of the letter sent to the Defense Department is attached as Item No. 3; a copy of one of the letters sent to the nonmilitary guaranteeing agencies is attached as Item No. 4. The Federal Reserve Banks were sent copies of both letters and invited to make any further comments.

Messrs. Forrestal and Massey then withdrew from the meeting.

Reorganization of data processing (Items 5 and 6). Discussions by the Board, most recently on August 3, 1966, of proposals for reorganization of the Division of Data Processing and computer applications had resulted in the appointment of a committee (the Computer Uses and Procedures Committee) comprised of Governor Mitchell as Chairman and the heads of designated divisions of the Board's staff. There had now been distributed a memorandum dated August 9, 1966, in which the Committee recommended that the Board adopt a statement of policy, a draft of which was attached, with respect to computer applications within the System and establish in general terms the procedures to be followed in carrying out this policy at the Board's offices. It was recommended that the policy statement, as adopted, be distributed to the Federal Reserve Banks. The Committee further recommended that staff resources representative of user divisions and the Division of Data Processing be assigned (1) to evaluate computer applications in each of the Board's divisions; (2) to catalogue available banking and other economic "data banks" at the Board, the Federal Reserve Banks, the Federal Deposit Insurance Corporation, and elsewhere, together with the retrieval facilities that are presently practically available; and (3) to determine whether or not existing System committees and assignments sufficiently implemented the policy position of the Board with respect to the automation of Reserve Bank operations.

Governor Mitchell commented on the work of the Committee in developing the statement, following which the other members of the Board expressed satisfaction with it. It was verified that the statement represented a satisfactory reconciliation of problems of various divisions of the Board's staff, without loss of data processing services considered essential to the accomplishment of their responsibilities.

At the conclusion of the discussion unanimous approval was given to the statement, and also to a letter transmitting it to the Federal Reserve Banks. Copies of the statement and the letter are attached as Items 5 and 6. The Board's action constituted approval of any budget overexpenditure incident to implementation of steps contemplated for reorganization of the Division of Data Processing and locating the Division in suitable quarters.

Messrs. Farrell, Johnson, Kakalec, Harris, Byrne, Kiley, Kern, Ring, and White then withdrew from the meeting.

Technical assistance for Korea. The members of the Board had been furnished copies of a memorandum of August 9, 1966, from Mr. Young regarding a request by the Ministry of Finance of Korea for an economist with considerable Federal Reserve experience to assist the Ministry and the Bank of Korea for a period of about one year. The memorandum described the tasks for which the adviser was needed and the administrative arrangements contemplated. Two members of the Board's staff had been mentioned in the request, but were not available for the assignment; the names of several other persons were suggested in the memorandum for the Board's consideration.

After a discussion during which the names of additional persons were offered as possibilities, it was understood that further exploration of the availability of certain of the persons who had been mentioned would be undertaken.

Foreign travel by Mrs. Junz. The Board authorized Mrs. Helen B. Junz of the Division of International Finance to make a three-day official visit to Brussels, Belgium, approximately September 14-16, 1966, with the understanding that the Board would pay her transportation expenses from Amsterdam to Brussels and return and that she would receive per diem in lieu of subsistence in accordance with the Standardized Government Travel Regulations.

The meeting then recessed and reconvened in the Board Room at 2:00 p.m. with the following attendance:

Mr. Robertson, Vice Chairman
Mr. Shepardson
Mr. Mitchell
Mr. Daane
Mr. Brimmer

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Young, Senior Adviser to the Board and Director, Division of International Finance
Mr. Holland, Adviser to the Board
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Brill, Director, Division of Research and Statistics
Mr. Partee, Associate Director, Division of Research and Statistics

Reserve requirements. The purpose of this meeting was to consider a proposal, set forth in a memorandum from the Vice Chairman dated August 9, 1966, for a further increase of one percentage point in the reserve requirement against time deposits (except savings deposits) in excess of $5 million in any member bank. The proposal envisaged announcing such action at the end of this week or at the beginning of next week, with an effective date of August 25 for reserve city banks and September 1 for other banks.

The Vice Chairman stated in his memorandum that the purpose of the increase in reserve requirements would be to further discourage reliance on certificates of deposit as a base for credit expansion in the face of continuing strong loan demands. The memorandum noted that banks might attempt to increase CD issuance this month in anticipation of enlarged September maturities and tax-period credit demands. As they did so, and as they also endeavored to roll over the relatively heavy progression of current maturities week by week, many large banks might be inclined to raise offering rates generally to the ceiling on minimum maturities, and perhaps on denominations under, as well as over, $100,000. In this environment, any additional increase in the cost of replacing CDs should reinforce the inducement to large banks to restrict customer loan accommodation as an alternative policy choice and to husband the liquidity of their asset portfolios against potential CD runoffs. Increasing these reserve requirements to the maximum would give further public indication that the Board meant to moderate both inflationary credit expansion and overly aggressive interest rate competition for savings. It would exhaust the Board's present authority to increase requirements on these deposits, and it would emphasize the need for the additional discretionary power recently requested of the Congress.

For assistance in considering the proposal the Board also had before it a memorandum from Messrs. Brill, Holland, and Partee dated August 10, prepared in response to the Board's request for staff assessment of the impact of the reserve requirement increase adopted by the Board at midyear and for specification of a consistent open market policy to implement a Board decision, if such should be made, to raise reserve requirements again. (There had also been distributed, with a covering memorandum from Mr. Holland dated August 9, a memorandum from Messrs. Fry and Beck of the Banking Section reviewing changes in marginal reserve measures following changes in reserve requirements since the passage of the Banking Act of 1935.)

A further document that had been made available to the Board was a memorandum dated August 11 in which Governor Daane stated that after reviewing the proposal and the staff memoranda, and discussing the possible market impact with the Manager of the System Open Market Account, he was opposed to the suggested reserve requirement action despite his feeling that the System should, in the absence of sufficient fiscal restraint, move further in the direction of credit tightening. The reasons for his position were, in brief, that the announcement effect, given the present market, would in his judgment have severe repercussions; that the action would intensify the problem faced by banks in September in replacing existing CDs without achieving the differential impact on bank credit expansion intended and desired; that the action would be used by the banks as a peg on which to hang a further increase in the prime rate; and that cushioning operations at a time when the System would normally be supplying reserves would necessitate much larger open market operations, with related technical difficulties. It seemed to him that further credit tightening could better be achieved through a further gradual tightening of open market operations.

Copies of all of the memoranda mentioned above have been placed in the Board's files.

At the beginning of today's meeting the Vice Chairman turned to Mr. Holland, who stated that he and his colleagues had tried to put before the Board in their August 10 memorandum the principal considerations as they saw them. He said that in the memorandum the staff had tended to understate, if anything, its views on the possible market impact of an announcement of the suggested move. The staff would anticipate a fairly substantial market reaction. The odds were thought to fall in the direction of the possibility, cited among others in the memorandum, that the announcement would produce a sharp rise in market rates, with a substantial CD runoff as one result. The most likely consequence would be a sharp rise in borrowing by the limited number of banks losing CDs, and thus a substantial short-run rise in net borrowed reserves. To bring market rates down sufficiently to slow the shrinkage of CDs to a pace that could be accommodated by orderly portfolio and lending policy adjustments, the System Account would need to provide reserves, and in the process reserve positions would be eased for banks not suffering large CD runoffs. The combination of increased borrowing and increased provision of nonborrowed reserves was likely to result in greater reserve expansion for a time than contemplated by policy objectives, and the higher borrowing might persist for a longer period if it proved hard to restore a viable relationship between CD rates and market rates.

Mr. Young said he was concerned because he thought the market was in a very tender condition. He wondered whether the gains from the suggested action were worth the market risks, with all that they implied. He noted certain instances that had come to his attention recently where banks were turning down substantial loan requests from prime customers.

Governor Robertson said he recognized the risks that were involved. It seemed to him, however, that the System had been unsuccessful in making monetary policy restrictive enough to curb the expansion of credit sufficiently. Since the System was going to be criticized in any event for the use of monetary policy to restrain inflationary pressures, it might as well obtain all of the benefits that a restrictive policy could achieve. In his opinion, net reserve availability must be cut down more than it had been thus far. As to the market risks, they were uncertain; perhaps action of this kind had already been more or less discounted and the market reaction to the announcement would be negligible. In any event, he would take the risk. If action was not taken now, the Board would be precluded from acting for some little period of time. It could act now on a basis that in his judgment would bring forth no criticism except from the banks, and that would be desirable. An opportunity was provided to emphasize the need for credit restriction and to make a contribution that the System thus far had not made. Any possible fiscal action would then have to flow from a more restrictive posture on the credit side.

Governor Robertson also said that the figures for the past reserve statement week pointed to a need for action of this kind as a tightening measure. In his judgment the Board should take advantage of the situation and move. The Board then should not weaken in the face of cries of distress, but instead push to make the action effective.

Governor Shepardson recalled that he had been greatly concerned during the whole recent period about trying to get control of the credit situation. It had been his feeling throughout that the System was moving too gradually, and he had expressed this view repeatedly at meetings of the Open Market Committee. Reduction of the availability of credit should be the prime target of the System, and in saying this he was not overlooking the impact on the rate structure. In principle, he thought there was some merit in moving toward a tightening of reserve availability on a continuing basis, as opposed to making significant moves at any one time. However, as he looked at the current reserve figures, he felt there had been a misappraisal by the Desk and that the line had not been held during the even-keel period to the extent that the Open Market Committee desired. He was not sure whether there was a reasonable prospect of obtaining a tightening of net reserve availability through the open market process to the extent that he would like. If there was any such assurance, he could see some advantage in using that instrument, for he recognized the hazards implicit in a reserve requirement action, but he was not confident that the results could be achieved through the open market process.

If the reserve requirement action was taken, Governor Shepardson continued, the Board should expect a good deal of complaint and cries of distress. The Board should have clearly in mind that it was not going to yield to them. It would be a serious mistake if, in response to such cries, Regulation Q ceilings were raised and reserves supplied through open market operations. He would expect, in the event of a large CD runoff, that the banks would increase their borrowing at the discount window and that the System would take care of this need, but only for the period necessary to allow portfolio and lending policy adjustments.

Governor Shepardson concluded by saying that he was still undecided whether one could reasonably count on getting more restraint through open market operations. If there was no reasonable expectation of this, it seemed to him that alternative action would be justified to obtain all the benefits possible from a policy of monetary restraint.

Governor Mitchell said he thought the Board should go ahead with the reserve requirement proposal, which would have some differential impact on the larger banks. In his judgment it was not such a large move as to have unduly severe market effects, and he believed more restraint was needed in this area. The suggested move was not perfect, but it seemed to be the best alternative available. Further, he felt that the Board should resist changing Regulation Q ceilings.

Governor Mitchell also referred to the "leakage" of domestic credit restraint policies through transfers from the foreign branches of a few U.S. banks and to the question whether a reserve requirement should be imposed against those deposits. He did not think this possibility should be thought of as an alternative to the action presently proposed, but it was something that might follow along later if the Board's assessment of the loophole indicated that action would be worth while.

Governor Daane said, in supplementation of his memorandum, that he thought the System should restrain credit availability further through open market operations. This could be done without running the risk--which he considered great--of having to negate the gain achieved from a reserve requirement through subsequent offsetting actions. It was well and good to say that the banks could simply be allowed to protest, but it seemed likely that the System would in fact have to do something in terms of reserve expansion, and probably on the Regulation Q ceilings also. He would prefer to probe further toward tightening through open market operations. Like Governor Shepardson, he was unhappy about the slippage indicated by the figures for the latest reserve week, but he would still prefer to tackle the problem through the open market instrument. On the reserve requirement proposal, he noted that the Board would not be precluded for all time from taking action, but he saw this as a poor time from the standpoint of market conditions.

Governor Daane also said he was not confident that a reserve requirement action could be taken without criticism from the Administration, particularly if the action should be used by the banks as a peg on which to hang an increase in the prime rate. While this did not go to the substantive issues, it deserved some consideration. On the question of timing, he thought that the apprehensions expressed concerning the sensitivity of the market were not overstated. There was a very real problem, as evidenced by the results of the recent Treasury financing and the way the market had been behaving.

Governor Daane concluded by saying that he considered the economic setting clearly inflationary and that he was in favor of using open market operations to tighten credit availability. He questioned the reserve requirement technique for dealing with the problem, with particular reference to the matter of timing.

> Secretary's Note: Interspersed throughout the discussion at this meeting were references by several Board members to conversations they

had had recently with various Treasury officials and, in one instance, a member of the Council of Economic Advisers. In some cases the conversations dealt specifically with the possibility of reserve requirement action; in other cases they dealt with monetary policy more generally. Impressions tended to be somewhat at variance, one with the other, concerning views held regarding the reserve requirement matter and possible reactions if an increase were to be announced.

Governor Brimmer suggested that a telephone conference meeting of the Federal Open Market Committee be held tomorrow, not to discuss the reserve requirement proposal specifically but to reassess the prospect of further tightening through open market operations between now and the date of the next regular Committee meeting (August 23) or between now and the time that the proposed change in reserve requirements would go into effect. If he could conclude from such a discussion that there was a reasonable chance of being able to effect some further gradual but persistent tightening through the open market process, he would prefer to pursue that course rather than to raise reserve requirements at this time. However, if he came away from the discussion convinced that there was little likelihood of such further tightening through open market operations, then he would want to take up the reserve requirement proposal as perhaps the only feasible alternative.

Governor Robertson commented on the difficulty involved in discussing a matter of this complexity in a telephone conference hookup and said he believed it would be futile to attempt to obtain commitments from Committee members in that fashion.

Governor Brimmer then commented that, like Governor Daane, he was not convinced that a reserve requirement action would escape criticism, especially if the banks then raised the prime rate. He also said that he was not convinced of the effectiveness of the reserve requirement action if the principal objective was to moderate business loan expansion, and it was on the business loan side that the main interest was focused at this time. He felt there was a reasonable prospect of getting some further overall tightening through open market operations. At its last meeting the Open Market Committee made a majority decision against further tightening in the context of Treasury financing, but now the Committee was at somewhat greater liberty to engage in further restraint. The forthcoming cash financing was not the type of operation that had customarily dictated an even keel.

Further, Governor Brimmer said, he would hate to provide a peg on which the banks could hang an increase in the prime rate. He would hope that the Board could tighten up on the leakage from overseas branches of American banks. Although this might not be a major item, he would regard a closing of the loophole as a move in the right direction. While he would not suggest such a move as a substitute for the present proposal, he would like to look at it again.

In view of the delicacy of the situation, Governor Brimmer concluded, he felt that a telephone meeting of the Open Market Committee should be held, even though it might not be the most efficient procedure.

The Board should assess every opportunity for credit tightening. He would not shrink from taking further credit-tightening action, but he would like to do this in the way that seemed most reasonable after weighing the alternatives.

Governor Robertson observed, with regard to the impact sought to be achieved by the reserve requirement proposal, that the impact of open market operations would be more widely spread. The reserve requirement action would hit at the larger institutions that were using CDs to gather funds to lend to businesses. The Board would come closer to exerting an impact in the business loan area through the reserve requirement move than the Committee would by tightening through open market operations. Further, if this move were made by the Board it would be much easier to reach the point where net borrowed reserves were in the $450-550 million range than if the Account Manager were instructed to move through open market operations toward that goal. The difficulties involved in moving down to a deeper net borrowed position through open market operations had been seen.

Governor Daane commented that, as between the two alternatives, there was a significant difference, in terms of market impact, because of the announcement effect attached to reserve requirement action.

Mr. Brill commented, in response to a request for his views, that if the market was in such a state that the reserve requirement action could not be taken without a danger of disorderly conditions, the question on his mind was how the market could be expected to absorb a significant tightening through open market operations. The real question, he suggested, was whether the System was estopped, because of the state of the market, from tightening through any mechanism. He supposed there would be a substantial market reaction if much deeper net borrowed reserve figures were published.

Governor Daane replied that he would not expect much deeper net borrowed reserve figures to be published immediately. He would simply try harder to press in the direction of moving down, but with no abrupt shift.

Governor Brimmer noted that in suggesting a telephone meeting of the Committee tomorrow his thought was to ascertain whether some general agreement on further tightening could be achieved, rather than to wait until the August 23 meeting. If there was such an agreement, the Manager could be instructed to begin to move toward deeper net borrowed reserve figures immediately, so some significant progress might be made by the dates that the proposed reserve requirement action would become effective, that is, by around the end of this month or early next month.

The Vice Chairman then suggested that the Board vote on the reserve requirement proposal. He questioned attempting to change open market policy during the inter-meeting period, and in any event it was only a matter of about 10 days until the next meeting. If the reserve requirement proposition was voted down, then an approach to the problem through the open market route would be in order, but the fixing of reserve requirements was the Board's responsibility. He felt the Board should decide the issue.

Governor Brimmer indicated at this point that he would like to hear further views on the proposal to hold an Open Market Committee telephone meeting, and Governor Mitchell expressed agreement with Governor Robertson that the issue at hand was too involved to be considered satisfactorily at a telephone meeting. Governor Shepardson concurred. Governor Daane indicated that he was somewhat more sympathetic toward the suggestion. While a telephone meeting was not an ideal procedure, the difficulties perhaps could be overcome. As had been noted, however, the time remaining until the next regular Committee meeting was relatively short. Governor Brimmer said he had just wanted to hear expressions of opinion on the matter.

A vote then was taken on the proposal to increase from 5 per cent to 6 per cent the reserve requirement against time deposits (other than savings deposits) over $5 million at any member bank, the action to be effective August 25 for reserve city banks and September 1 for other member banks.

Vice Chairman Robertson and Governors Shepardson and Mitchell voted in favor of the proposed action, while Governors Daane and Brimmer voted against it.

(In voting, Governor Shepardson said he would prefer it if the restraint he felt was necessary could be achieved through the open market process, but that he was doubtful whether this could be accomplished.)

According to the provisions of section 19 of the Federal Reserve Act a change in reserve requirements requires the affirmative vote of not less than four of the members of the Board of Governors. Accordingly, the reserve requirement proposal on which the vote had been taken failed of approval.

The meeting then adjourned.

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

Memorandum from the Office of the Secretary dated August 11, 1966, requesting authorization to proceed with the necessary arrangements for a visit of the trainees from the Center for Latin American Monetary Studies during the period September 6-9, 1966, with a bus tour of Washington and visit to Mount Vernon, including luncheon, on September 10. (The authorization contemplated proceeding within the scope of funds provided for this purpose in the 1966 budget.)

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

Appointments

Helen C. Droitsch as Clerk-Typist, Division of Personnel Administration, with basic annual salary at the rate of $4,701, effective the date of entrance upon duty.

Ann Marie G. Petro as Stenographer, Division of Personnel Administration, with basic annual salary at the rate of $4,936, effective the date of entrance upon duty.

Appointment

Jo Anne Young as Statistical Clerk, Division of Research and Statistics, with basic annual salary at the rate of $4,776, effective the date of entrance upon duty.

Transfers

Mary C. Deese, from the position of Records Clerk in the Office of the Secretary to the position of Statistical Clerk in the Division of Research and Statistics, with no change in basic annual salary at the rate of $4,776, effective upon assuming her new duties.

Robert G. Sampson, from the position of Personnel Assistant in the Division of Personnel Administration to the position of Administrative Assistant in the Division of Data Processing, with no change in basic annual salary at the rate of $9,536, effective August 15, 1966.

Merritt Sherman

Secretary

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

Item No. 1
8/11/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 11, 1966

Board of Directors,
The Union Bank,
Loogootee, Indiana.

Gentlemen:

The Federal Reserve Bank of St. Louis has forwarded to the Board of Governors a letter dated August 3, 1966, signed by Cashier Arvin signifying your intention to withdraw from membership in the Federal Reserve System and requesting waiver of the six months' notice of such withdrawal, together with an accompanying resolution dated August 1, 1966.

The Board of Governors waives the requirement of six months' notice of withdrawal. Under the provisions of Section 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 St. Louis of the Federal Reserve 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 St. Louis.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 2
8/11/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 11, 1966

Mr. Daniel B. Goldberg,
Associate Counsel in New York,
The Port of New York Authority,
11 Eighth Avenue - at 15th Street,
New York, New York. 10011

Dear Mr. Goldberg:

In response to your letter of July 28, 1966, there is enclosed a copy of a letter dated October 23, 1934, from the Comptroller of the Currency to J. D. Van Hooser and Company, Lexington, Kentucky.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure

C O P Y

October 23, 1934.

J. D. Van Hooser and Company,
Investment Securities,
Security Trust Building,
Lexington, Kentucky.

Gentlemen:

Reference is had to your inquiry of October 9 addressed to the Federal Reserve Board and in turn referred to this office for reply.

You particularly request an interpretation of Section 16 of the Banking Act of 1933 with respect to dealing in, underwriting, and purchasing of securities, and the exception therein that the limitations and restrictions in question shall not apply to obligations of the United States or general obligations of any State or of any political subdivision thereof. You desire to have our interpretation of the expression "general obligations" as used in this statute.

It is the practice of this office to consider the term, "general obligations", as used in the various provisions of the National Bank Act as referring to obligations which are payable either directly or ultimately, without limitation to a special fund, from the proceeds of taxes authorized to be levied upon all the taxable real and personal property within the limits of the governmental entity issuing such obligation. This naturally excludes all classes of special obligations which are payable solely out of a special fund derived from special assessment or other limited sources. One applicable test is whether or not the holder of such general obligations will be entitled to a writ of mandamus to compel the levy and collection of a tax upon all the taxable property of a State or political subdivision which issued the obligation.

You further desire a ruling as to whether or not banks dealing in securities on behalf of their customers are permitted to make a service charge which is equivalent in amount to what they had previously charged for brokerage on similar orders.

We can only consider this question from the standpoint of the national banks, and this office has never considered it proper for a national bank to make what may be termed brokerage charges on such transaction. The banks have been instructed that any charge made in connection with such transaction must not exceed the actual cost of servicing. It is realized that there are many elements that enter into the cost of such service which are not susceptible to definite ascertainment. We are primarily concerned that the bank avoid any appearance of acting in a brokerage capacity even from a fee standpoint and are of the opinion that if any fee is to be charged, it shall be primarily based on cost of service rather than on the size of the transaction.

Very truly yours,

J. F. T. O'CONNOR,
Comptroller.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 3
8/11/66

OFFICE OF THE VICE CHAIRMAN

August 15, 1966.

The Honorable J. M. Malloy,
Deputy Assistant Secretary of Defense
(Procurement),
Department of Defense,
Washington, D. C. 20301

Dear Mr. Malloy:

This refers further to the Board's letter of June 10, 1966, relating to a possible increase in the maximum rate of interest on so-called "V-loans", i.e., loans by commercial banks to defense production contractors guaranteed by certain agencies of the Government.

In the light of responses from the guaranteeing agencies, the Board is now prepared

(1) to increase the maximum rate of interest on such loans from 6 per cent to 7-1/2 per cent; and

(2) to provide, however, that where the loan rate is more than 6 per cent, the guarantee fee shall nevertheless continue to be computed as though the loan rate was 6 per cent.

The proposed maximum interest rate would be three points above the present Federal Reserve Bank discount rate. It would not, however, be expressly related to the current discount rate, since it is our understanding that the Treasury Department as a matter of policy would not favor such a specific relation of the maximum loan rate on V-loans or other Government guaranteed V-loans to the current Federal Reserve discount rate.

The Board has carefully considered the suggestion made in your letter of July 26, 1966, that the present schedule of guarantee fees be revised in the manner there set forth. The proposed revision would increase guarantee fees on loans guaranteed between 50 and 90 per cent. It is questionable in the Board's opinion whether banks would be willing to make V-loans with guarantees of less than 50 per cent.

If the guarantee fees were raised along with the maximum loan rate, the increase in the maximum loan rate might not be sufficient in the light of the increased risk to the bank to make a lower percentage of guarantee attractive. Consequently, it is the tentative view of the Board that the suggested revision would not accomplish the objective of inducing banks to request lower percentages of guarantee and that it would be preferable to make no change in the present schedule of guarantee fees, at least at this time.

In the circumstances, before taking any action in the matter, the Board is addressing letters, in the form enclosed, to the guaranteeing agencies other than the Departments of the Army, Navy, and Air Force, and the Defense Supply Agency, requesting their views regarding the suggested revision of the schedule of guarantee fees. Since your letter of July 26, 1966, indicated that it was written in response to the Board's letters of June 10, 1966, to the Secretaries of the Army, Navy, and Air Force, and to the Director of the Defense Supply Agency, we are not addressing similar letters to those agencies.

The Board would, of course, appreciate any further thoughts that you may have regarding this question.

Sincerely,

(Signed) J. L. Robertson

J. L. Robertson.

Enclosure

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 4
8/11/66

OFFICE OF THE VICE CHAIRMAN

August 15, 1966

The Honorable Orville L. Freeman,
Secretary of Agriculture,
Washington, D. C. 20250

Dear Mr. Secretary:

This refers further to the Board's letter of June 10, 1966, relating to a possible increase in the maximum rate of interest on so-called "V-loans", i.e., loans by commercial banks to defense production contractors guaranteed by certain agencies of the Government.

In the light of responses from the guaranteeing agencies, the Board is now prepared

(1) to increase the maximum rate of interest on such loans from 6 per cent to 7-1/2 per cent; and

(2) to provide, however, that where the loan rate is more than 6 per cent, the guarantee fee shall nevertheless continue to be computed as though the loan rate was 6 per cent.

The proposed maximum interest rate would be three points above the present Federal Reserve Bank discount rate. It would not, however, be expressly related to the current discount rate, since it is our understanding that the Treasury Department as a matter of policy would not favor such a specific relation of the maximum loan rate on V-loans or other Government guaranteed V-loans to the current Federal Reserve discount rate.

With the thought that it might provide "more inducement for lower percentages of guarantee", the Department of Defense has suggested a revision of the present schedule of guarantee fees as follows:

Per cent of loan guaranteed	Guarantee Fee (Per cent of interest payable by borrower on guaranteed portion of loan)
50 or less	10
55	12-1/2
60	15
65	17-1/2
70	20
75	22-1/2
80	25
85	27-1/2
90	30
95	35
Over 95	40 - 50

For the purpose of comparison, the existing schedule is as follows:

Per cent of loan guaranteed	Guarantee Fee (Per cent of interest payable by borrower on guaranteed portion of loan)
70 or less	10
75	15
80	20
85	25
90	30
95	35
Over 95	40 - 50

Since the proposed revision would increase guarantee fees on loans guaranteed between 50 and 90 per cent, and since it is questionable whether banks would be willing to make V-loans with guarantees of less than 50 per cent, the Board is tentatively of the view that the suggested revision would not accomplish its objective and that the present schedule should not be changed at this time. However, before taking any action in this matter, the Board would appreciate your views regarding this suggestion as promptly as possible, preferably by August 22, 1966.

Sincerely,

(Signed) J. L. Robertson

J. L. Robertson.

Item No. 5
8/11/66

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Plan for Reorganization of Board's Data Processing Division and Activities

A reorganization of the Board's Data Processing Division and activities is being adopted at this time for two reasons: first, to attain the potential benefits of a more powerful and complex computer (an IBM 360 system); and, second, as an outgrowth of discussions centering around a series of recommendations on computer utilization and data handling by the recently-appointed Division Director.

The two circumstances, taken in combination, involve rather substantial operational and structural changes in staffing and allocation of functions within the Board's organization. But more important, the Board takes this occasion to recognize the potential role of the computer and data transmission technology as revolutionary tools in the more efficient functioning of the Federal Reserve System as a whole.

Role of computer in data handling and in economic and financial analysis

To date the Board's computer facilities have been playing an essentially passive role in the planning and processing of data assembly. Banking data needs have been, and still are, often substantially compromised and constrained by factors such as the compliance costs inherent in hand tabulation and the use of forms instead of machine-readable media. To a significant extent our quantitative data are too meager and too late because of the limited use of advanced statistical techniques and the forcing of computer technology into a replication of hand tabulating. Even the regional data-gathering system--one of the great advantages of the System's intelligence network--seems to be ignoring the potentials of evolving computer technology.

Attention, then, should now be directed toward the specific means by which the computer can improve its contribution to the Board's basic informational needs, and this clearly involves considerable reappraisal of those needs. Such reappraisal and evaluation should be undertaken by all of the Board's divisions, particularly Research, International, Bank Operations, and Examinations, in cooperation with the Data Processing Division.

Existing computer programs and extant "data banks" can provide informational services in the near future to an extent that is not generally realized by many potential analysts and other users among the Board's staff. A catalogue of existing computational resources as well as those that will shortly become available, both at the Board and other agencies, should be prepared and made generally available. It is just as important for users to be aware of the contribution that the computer can make to their needs from existing sources and techniques as it is for them to be defining new specifications for programs and data assembly.

The use of the computer complex in assisting economic analysis is equally as important as the use of the computer in compiling data in orderly, comprehensive, and accessible fashion. This involves both the development of new analytic techniques, involving substantial experimentation, and the application of existing techniques to new data and new problems. The power and speed of the Board's new computer system can contribute significantly to improvements in monetary theory and to the application of theory to current problems, for example in projections of the impact of policy under alternative assumptions and conditions. For both developmental and application work, a great degree of flexibility will be needed in any new procedures developed for the use of the computer.

Role of the computer in System operations

Technology and opportunity for improved applications are advancing at a rapid rate in the computer-communications field. While individual Federal Reserve Banks have already made substantial progress, much remains to be accomplished, particularly on a System basis.

Those applications limited to internal housekeeping operations or of strictly local effect have been taken care of to a substantial extent. However, the more important applications are those in which computer technology has not achieved its true potential, because they are of such magnitude as to entail System-wide programs and policies or even some centralized processing. Projects of such scope as more efficient currency handling (as a result of redesign of the currency) or improved check processing or other forms of money settlement require overall plans that must of necessity be formulated through the cooperative endeavors of the Board and the Reserve Banks.

From the Board's standpoint, the continuing objective is to work most effectively with the Reserve Banks in taking advantage of the latest developments in data processing and data transmission technology. While the Board cannot assume responsibility for day-to-day operations at the Reserve Banks, it must be in a position to develop an informed opinion on the effectiveness of the use by the Banks of computer resources, and it must contribute its full share of leadership in determining the optimum role of the computer.

From the information currently available, it appears that many phases of system operations can be substantially improved by greater use of advancing computer-communications technology. However, in order that the Board may be able to consider knowledgeably the broad issues involved in the application of such technology to the efficiency of System operations, it is clear that further task force studies by the responsible operating divisions and by qualified Board and Bank personnel are necessary.

The Division of Data Processing should stand ready to participate in these studies by providing technical advice and the services of specialists in developing and evaluating computer-communications applications in the major phases of System operations.

Steps presently authorized

For the time being, Board action with respect to the reorganization of its data processing activities is confined to the following steps, it being understood that specific actions implementing these steps are subject, in appropriate instances, to the approval of the Board member (Governor Shepardson) having responsibility for internal administrative affairs after review by the Division of Personnel Administration and the Office of the Controller in accordance with existing procedures:

(1) Subject to such exceptions as may be approved for temporary periods, all full-time programmers are to be located in the Division of Data Processing and will operate under its supervision. However, this is not to be construed as prohibiting or discouraging other staff members from engaging in programming activities to the degree that their assignments, competence, and interests dictate. Nor are such programming activities to be accorded, simply by reason of that fact, a lower priority in the scheduling of computer availability.

(2) The actual operation of the computer shall be the exclusive responsibility of the Data Processing Division. The scheduling of computer time shall also be the responsibility of that Division, subject to the explicit caveat that basic priorities must be determined by the using divisions rather than the Data Processing Division. If conflicts arise, basic priorities will be decided by the Board, or through the mechanism of its Computer Uses and Procedures Committee. The Committee will supplement the general statement of Board policy with appropriate outlines of procedure for computer usage to such extent as may be necessary.

(3) The Division of Data Processing is authorized to augment its staff to the extent necessary to service user needs efficiently, with due consideration to the availability of existing programs, data banks, and retrieval programs that may meet certain needs satisfactorily and economically.

(4) The Division of Data Processing is also authorized to employ such staff as it needs to participate effectively in studies conducted by the operating divisions of the Board and by the Reserve Banks for the purpose of improving efficiency throughout the System by utilizing wherever possible the most advanced computer, communications, and analytical techniques, with the understanding that participation in any such studies at individual Reserve Banks will be planned in consultation with the operating divisions of the Board having primary responsibility for the activities concerned.

(5) It is understood that the Data Processing Division, working in cooperation with other interested divisions and offices of the Board's staff and the Computer Uses and Procedures Committee, will prepare for the Board's consideration recommendations relating to the level of computer capability that should be provided at the Culpeper relocation site on a continuing basis.

(6) In authorizing this reorganization of its data processing activities, including the recruitment of needed staff and acquisition of appropriate working space, the Board

expects that the expenditure will produce tangible results not inherent in the present method of operations. It instructs the Division of Data Processing, in cooperation with the Office of the Controller, to maintain records of its costs and performance such that the total Board program, and elements thereof, can be evaluated effectively, including records that will assist prospective users of the facilities in evaluating various contemplated projects. It is understood, however, that the Division of Data Processing cannot be responsible for cost-effectiveness determinations pertaining to those computer-related activities or products over which that Division has no control.

The Board understands that the Computer Uses and Procedures Committee will maintain itself in a state of readiness to deal with significant operational or other problems that may emerge as the reorganization of data processing activities takes place. It also looks to this Committee to see to it that the various studies and task force reports referred to above are gotten under way and are brought to the Board's attention at the earliest possible date.

August 11, 1966

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

Item No. 6
8/11/66

August 12, 1966.

Dear Sir:

In order to achieve the potential benefits of a new computer (an IBM 360 system), and as an outgrowth of discussions centering around a series of staff recommendations on computer utilization and data handling, the Board has decided upon a reorganization of its Data Processing Division and related activities. In that connection the Board has adopted the enclosed statement of policy on computer applications within the Federal Reserve System and has established general procedures to be followed in carrying out this policy at the Board's offices.

It will be noted that the statement of policy is contained in the first part of the document, specifically in the sections relating to (1) the role of the computer in data handling and in economic and financial analysis, and (2) the role of the computer in System operations. The third section, which sets forth principally certain steps presently authorized in connection with the reorganization of the Board's data processing activities, should also be read in part as an addendum to the Board's set of directives to its staff dated May 26, 1965, copies of which were sent to the Reserve Banks on the same date, describing the allocation to the several divisions and offices of the Board of responsibilities pertaining to relationships with the Reserve Banks.

The Computer Uses and Procedures Committee, referred to at various places in the enclosed document, consists of a member of the Board (Governor Mitchell) and the heads of most of the divisions of the Board's staff.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS