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 Monday, August 22, 1966. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Shepardson, Acting Chairman
          Mr. Mitchell
          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. Holland, Adviser to the Board
          Mr. Molony, Assistant to the Board
          Mr. Cardon, Legislative Counsel
          Mr. Fauver, Assistant to the Board
          Miss Eaton, General Assistant, Office of the Secretary
          Mr. Furth, Consultant
          Messrs. Irvine, Katz, Reynolds, Bryant, Dahl, Gemmill, Lee, Marlin, Mills, and Nettles, and Mrs. Junz of the Division of International Finance

Economic review. The Division of International Finance presented a summary of international financial developments, following which the Division of Research and Statistics reviewed domestic economic trends. The presentations were based to a certain extent on materials that had been distributed in preparation for tomorrow's meeting of the Federal Open Market Committee. Copies of the relevant documents have been placed in the Committee's files.
All members of the research staff except Messrs. Brill, Partee, and Dahl then withdrew from the meeting and Messrs. Hackley, General Counsel; Farrell, Director, Division of Bank Operations; and Goodman, Leavitt, and Egertson of the Division of Examinations entered the room.

Approved letters. The following letters were approved unanimously after consideration of background information and draft material that had been made available to the members of the Board:

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<th>Item No.</th>
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<td>1</td>
<td>Letter to Bank of Delaware, Wilmington, Delaware, approving the establishment of a branch in the Penn Mart Shopping Center, New Castle County.</td>
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<td>2-3</td>
<td>Letters to Central Bank, Grand Rapids, Michigan, approving the establishment of branches at 3100 Plainfield Avenue, N.E., and 161 Ottawa Avenue, N.W., Grand Rapids.</td>
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<tr>
<td>4</td>
<td>Letter to First National City Overseas Investment Corporation, New York, New York, granting permission to acquire 20 per cent of the capital stock of a Brazilian investment bank presently being formed.</td>
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<td>5</td>
<td>Letter to Chairman Fascell of the Subcommittee on Legal and Monetary Affairs of the House Committee on Government Operations regarding the differential between maximum rates permitted to be paid by member banks on time and on savings deposits, and related matters.</td>
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<tr>
<td>6</td>
<td>Letter to Chairman Fascell commenting on discount administration in light of the differential between the Federal Reserve discount rate, the Federal funds rate, and the commercial bank prime rate.</td>
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Minneapolis discount rates. It was agreed to defer until Wednesday, August 24, consideration of action taken by the directors.
of the Federal Reserve Bank of Minneapolis establishing a rate of 5-1/2 per cent on discounts for and advances to member banks under sections 13 and 13a of the Federal Reserve Act along with corresponding subsidiary rates on discounts and advances, the thought being that the proposed rates could then be reviewed in the light of discussion at tomorrow's meeting of the Federal Open Market Committee and at the contemplated meeting of the Board and the Presidents on the current proposal for adjustment of discount administration.

Members of the staff other than Messrs. Sherman, Kenyon, Young, Holland, Brill, Partee, and Furth then withdrew from the meeting.

Effect of discount administration proposal on formulation of open market policy. Mr. Holland and other members of the staff brought before the Board for consideration certain problems that had been encountered in the formulation of draft current economic policy directives for the Federal Open Market Committee, for use at the Committee meeting tomorrow, because of uncertainties in projections reflecting partly the pendency of the discount administration proposal, adoption of which might have a bearing on the volume of borrowing by member banks through the discount window. It was suggested that the proceedings tomorrow begin with a joint meeting of the Board and the Presidents on the matter of discount administration since a decision thereon would be helpful to the Open Market Committee in determining a framework for the formulation of open market policy and issuance of a directive.
There was general agreement with this procedural suggestion, which it
was understood would be discussed with Vice Chairman Robertson and Vice
Chairman Hayes of the Open Market Committee.

Swap network. Reference was made to staff documents that had
been distributed to the Open Market Committee regarding a proposal by
the Special Manager of the System Open Market Account to negotiate an
enlargement of the Federal Reserve swap network. It was reported that
consideration currently was being given by an interagency Government
committee headed by Mr. Deming of the Treasury (at meetings attended
by Governor Daane) to the formulation of U.S. international financial
policy in light of current pressures on the pound sterling and that an
enlargement of the swap network had come under discussion as one of the
possible components of such policy. The result of today's discussion
was an agreement that it would seem appropriate for the Open Market
Committee to discuss Mr. Coombs' proposal at its meeting tomorrow, but
with the understanding that implementation of any action decided upon
by the Committee would be contingent upon the receipt of advice by the
Chairman or Acting Chairman of the Board of Governors from the Secretary
of the Treasury that such action would be considered an appropriate part
of U.S. international financial policy as determined by the Administration.

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:
Appointment

Herbert Mertz, Jr., as Purchasing Assistant, Division of Administrative Services, with basic annual salary at the rate of $6,461, effective the date of entrance upon duty.

Transfers

Edward J. Finck, from the position of Purchasing Assistant in the Division of Administrative Services to the position of Operator, Tabulating Equipment, in the Division of Data Processing, with an adjustment in basic annual salary from $6,659 to $6,216, effective August 28, 1966.

Lee R. Thompson, from the position of Operator, Tabulating Equipment, to the position of Digital Computer Systems Operator (Trainee), Division of Data Processing, with no change in basic annual salary at the rate of $4,776, effective August 28, 1966.

Lyla E. Szillat, from the position of Digital Computer Systems Operator to the position of Control Clerk, Division of Data Processing, with no change in basic annual salary at the rate of $6,563, effective August 28, 1966.

Secretary
August 22, 1966

Board of Directors,
Bank of Delaware,
Wilmington, Delaware.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Bank of Delaware, Wilmington, Delaware, of a branch in the Penn Mart Shopping Center located at the intersection of duPont Highway and Basin Road, New Castle Hundred, New Castle County, Delaware, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)
August 22, 1966

Board of Directors,
Central Bank,
Grand Rapids, Michigan.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Central Bank, Grand Rapids, Michigan, of a branch at 3100 Plainfield Avenue, N.E., Grand Rapids, Michigan, provided the branch is established within six months from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)
August 22, 1966

Board of Directors,
Central Bank,
Grand Rapids, Michigan.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Central Bank, Grand Rapids, Michigan, of a branch at 161 Ottawa Avenue, N.W., Grand Rapids, Michigan, provided the branch is established within six months from the date of this letter.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

(The letter to the Reserve Bank stated that the Board also had approved a six-month extension of the period allowed to establish the branch; and that if an extension should be requested, the procedure prescribed in the Board's letter of November 9, 1962 (S-1846), should be followed.)
August 22, 1966.

First National City Overseas
Investment Corporation,
399 Park Avenue,
New York, New York. 10022

Gentlemen:

As requested in your letter of July 12, 1966, the Board of Governors grants consent for your Corporation to purchase and hold up to 20 per cent of the capital stock of a Brazilian investment bank, in process of formation, to be located initially in Sao Paulo, Brazil, at a cost of approximately US$500,000, provided such stock is acquired within one year from the date of this letter.

The Board also approves the purchase and holding of the above-mentioned stock within the terms of the above consent in excess of 15 per cent of your Corporation's capital and surplus.

The foregoing consent is given with the understanding that the investment now being approved, combined with other foreign loans and investments of your Corporation, First National City Bank, and International Banking Corporation, 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.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.
The Honorable Dante B. Fascell, Chairman, Legal and Monetary Affairs Subcommittee, Rayburn House Office Building, Washington, D. C. 20515

Dear Mr. Chairman:

This is in reply to your letter of July 11, 1966, requesting comments on the reasons for the differential between maximum permissible rates member banks may pay on time and savings deposits and on related questions.

Some differential in maximum rates between savings deposits and time deposits is in our opinion justified by the different nature of the two deposit forms. Savings deposits are more liquid than time deposits, a characteristic which suggests that their rate of return should be lower. To be sure, a bank has the right to require its customers to wait 30 days before withdrawing a savings deposit, but in practice this requirement is not used. As is the practice among savings and loan associations and other savings institutions, passbook-type deposits generally are payable on demand. Time certificates of deposit, on the other hand, have a specific maturity or notification requirement, and they cannot be redeemed before the end of the required period except in hardship circumstances. In exchange for this reduction in liquidity, the depositor requires a higher rate of return.

When the Board increased the maximum permissible rate for time deposits to 5-1/2 per cent in December 1965, credit demands were growing rapidly and market rates of interest were rising. In that environment, when the Federal Reserve decided to raise the discount rate, it was felt advisable to raise the maximum rate on time deposits as well, so that banks could remain competitive in the money market. With some banks already paying the old limit on large denomination negotiable certificates of deposit, and with money market rates rising,
failure to adjust the rate ceiling in some degree would have precipitated sharp run-offs of these interest-sensitive funds with a consequence of considerable contraction in bank credit. So sharp a move was deemed inappropriate in the economic situation then prevailing. Rather, it was hoped that a substantial increase in the ceiling and a broadening of the maturity spectrum would provide leeway for banks to compete for money market funds, while in the short-run not encouraging any tendency toward an automatic mass movement by banks to the new ceilings for all types of time deposits.

On the other hand, the higher liquidity of savings deposits, as well as their more direct competition with savings and loan shares and mutual savings bank deposits, suggested that the ceiling on these deposits should remain unchanged. This was intended to minimize the impact on competitive relationships between commercial banks and other savings institutions. Thus, commercial banks were permitted the option of attracting highly interest-sensitive and less liquid funds by using time deposits, but they were restrained from more intense direct competition with other institutions for liquid savings balances.

As you know, this policy has been reinforced by three other recent Board actions. In order to make time deposits more expensive for banks and thus temper bank competition for funds, reserve requirements have been twice raised on all time deposits (these do not include savings deposits) in excess of $5 million per bank—from 4 per cent to 5 per cent to be effective in July, and from 5 per cent to 6 per cent to be effective in September. Also, in mid-July the Board reduced the maximum rate banks may pay on time deposits with multiple maturities of 90 days or more to 5 per cent and for those with maturities of less than 90 days to 4 per cent. This type of deposit was being used increasingly by a few banks in efforts to attract more liquid funds. Both of these actions were designed to moderate rate competition among financial institutions and to help curb expansion of bank credit.

Large denomination negotiable certificates of deposit trade in a secondary market that is free of any official interference. For example, on August 10 negotiable CD's issued by large New York City banks were traded in the secondary market to yield 5.50 to 6.00 per cent, depending on maturity. Since the maximum rate banks can pay on such deposits is 5-1/2 per cent, the sellers, of course, had to sell them at a capital loss. The Board has no authority to control this secondary market. These certificates are money market instruments held mainly by large corporations and must compete against other high quality short-term investments such as Treasury bills and commercial paper, the yields on which are also determined by supply and demand conditions. This seems a normal and desirable market function, and the Board does not now feel it would be advisable to regulate market trading on negotiable CD's.
The establishment of maximum rates on time and savings deposits is a matter of judgment as well as analysis, particularly when the relevant conditions are changing rapidly, as has been the case this year. We are endeavoring to keep abreast of these developments, and we appreciate your interest in them.

Sincerely yours,

Chas. N. Shepardson.
August 23, 1966

The Honorable Dante B. Fascell, Chairman,
Legal and Monetary Affairs Subcommittee,
House Committee on Government Operations,
Room B349-A, Rayburn House Office Building,
Washington, D. C. 20515

Dear Mr. Chairman:

This refers to your letter of July 11, 1966, concerning
the Wall Street Journal comments on the possible effects of the
present spread between the discount rate and the Federal funds rate.

The discount rate, as a cost of credit, tends to limit
the amount of credit demanded by member banks. However, at this time
the amount of credit extended is bounded not so much by rate as by
other elements of Federal Reserve discount policy. Credit is intended
to be available, during periods of monetary restraint as well as
ease, to facilitate the adjustment of banks to the types of fluctuations
in deposits and loan demand which periodically occur in the banking
industry and which, without the use of credit, could be extremely
disruptive to bank operations and to the economies of the communities
which banks serve. The Board's Regulation A sets forth various purposes,
for the most part temporary, for which member banks may appropriately
borrow from the Federal Reserve Banks. Administrative action at each
Reserve Bank works to restrict bank borrowings to the amounts needed
for such "appropriate" purposes.

Administrative action to limit borrowing to relend in the
Federal funds market, as in other markets, is based principally on
the express restriction in Regulation A against bank "borrowing
principally for the purpose of profiting from interest rate differentials."
This restriction is supported by a discount policy which requires that
borrowing banks adjust their portfolios and lending policies as quickly
as practicable to increased pressure on their reserves. Under the
terms of Regulation A, continuous borrowing is generally regarded as
inappropriate.
In order to implement the administrative restraints indicated by Regulation A, the Reserve Banks stay abreast of the operations of borrowing member banks. Reserve Bank officials obtain and review a variety of balance sheet data in the course of their normal procedures. Daily deposit figures are reported at least once a week by all member banks; data on loans and securities are received weekly from large banks and biweekly from all other banks; condition reports for all member banks, providing a considerable amount of detail, are obtained several times a year; and reports of examinations performed on the premises of each member bank are also available at least once a year. In addition, continuous communication is maintained between Reserve Banks and borrowing banks, and supplementary information is called for if needed to clarify the circumstances surrounding the borrowing. Through these media, the Reserve Banks become aware promptly when member banks are making inappropriate use of borrowed funds and act to have the situations corrected. This kind of enforcement of Regulation A is effected without regard to the size of the borrowing bank.

As a result of these administrative procedures, it has been possible to have a discount rate which, by the nature of bank operations, is always below most rates on earning assets held by banks, and much lower than some rates. This is to be expected since borrowings at Reserve Banks, besides being restricted as to purpose, are well secured liabilities of the borrowing bank. The discount rate has typically been below the prime rate, but until recently above or equal to the Federal funds rate. Attached is a chart showing movements in the discount rate, the prime rate, and the Federal funds rate since 1957. You may note that the spread between the prime rate and the discount rate over this period has typically been about 1 percentage point. For several months in mid-1958, however, a spread of 2 percentage points existed, and in the mid-1960 - mid-1963 period a spread of 1-1/2 points was consistently maintained. Looked at in this light, today's spread of 1-1/2 points between the prime and discount rates does not seem per se excessive.

In early 1965, the effective Federal funds rate also moved above the discount rate, creating, as you indicate in your letter, an added incentive to borrow. In kind, this particular rate incentive is little different from other rate incentives that have existed in the past, but it is recognized that the degree of borrowing pressure is enhanced by the amount of the current differential in rates. Accordingly, Federal Reserve discount administrators pay special attention to the Federal funds activity of borrowing banks, and in
the infrequent cases where banks are found to be borrowing from the Federal Reserve to resell the funds in the Federal funds market, the offending member bank is contacted to terminate the practice.

Our administrative procedures, supported by the flow of information described above, have been and, we believe, continue to be, adequate to deal with the problems of banks borrowing and reselling Federal funds. However, notwithstanding what we believe to be the good performance in administration of the discount window to date, the Federal Reserve is continuing to watch borrowing trends closely and to keep its administrative officials on guard against possible abuses of the borrowing privilege accorded to member banks. We recognize that the economic environment changes constantly and our policies and tools should be examined periodically to evaluate their effectiveness. As a matter of fact, the Federal Reserve is presently engaged in a comprehensive re-evaluation of discounting in general, and of Regulation A in particular. This study is described in the Annual Report of the Board of Governors of the Federal Reserve System, 1965, the relevant section of which is also enclosed.

Sincerely yours,

[Signature]

Chas. N. Shepardson

Enclosures