

Minutes for August 31, 1966

To: Members of the Board

From: Office of the Secretary

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

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

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

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

Minutes of the Board of Governors of the Federal Reserve System on Wednesday, August 31, 1966. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. Broida, Assistant Secretary  
Mr. Bakke, Assistant Secretary  
Mr. Young, Senior Adviser to the Board and Director,  
Division of International Finance  
Mr. Holland, Adviser to the Board  
Mr. Solomon, Adviser to the Board  
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. Kelleher, Director, Division of Administrative  
Services  
Mr. Kakalec, Controller  
Mr. Harris, Coordinator of Defense Planning  
Mr. Hexter, Associate General Counsel  
Mr. O'Connell, Assistant General Counsel  
Mr. Shay, Assistant General Counsel  
Mr. Katz, Adviser, Division of International  
Finance  
Mr. Daniels, Assistant Director, Division of  
Bank Operations  
Mr. Goodman, Assistant Director, Division of  
Examinations  
Mr. Leavitt, Assistant Director, Division of  
Examinations  
Mr. Smith, Assistant Director, Division of  
Examinations  
Messrs. Forrestal and Smith of the Legal Division  
Mr. Fry of the Division of Research and Statistics  
Mr. Grimwood of the Division of International  
Finance  
Messrs. Burton, Goodfellow, and Lyon of the  
Division of Examinations  
Mr. Furth, Consultant

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Communications and Records Center (Item No. 1). In a letter of August 26, 1966, the Federal Reserve Bank of Richmond reported on bids received for the construction of a Communications and Records Center at Culpeper, Virginia, and requested approval of the action of the Bank's Building Committee in authorizing contracts totaling \$4,816,804 with the low bidders for the general construction, elevator, food service equipment, and vault doors and equipment. Authority for a contingency allowance of \$258,873 was also requested. The estimated total project cost was \$5,436,333, including architects' fees, an off-site sewer system on which bids were to be asked later, and the contingency allowance.

A distributed memorandum from the Division of Bank Operations dated August 30, 1966, recommended authorizing the Reserve Bank to proceed with the project through expenditure of approximately \$5,500,000, including architects' fees and the contingency allowance.

After discussion, the telegram authorizing the expenditure was approved unanimously. A copy is attached as Item No. 1.

Messrs. Kelleher and Kakalec then withdrew from the meeting.

Associated Bancorporation. Mr. O'Connell referred to the application of Associated Bancorporation, Milwaukee, Wisconsin, to become a bank holding company through acquisition of shares of two banks, including Milwaukee Western Bank of Milwaukee. He noted that the filing of the Hearing Examiner's report and recommended decision had previously

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been stayed in view of information that had come to light reflecting deterioration of the condition of Milwaukee Western Bank. He then cited evidence of such deterioration found in the report of examination of that bank made in May 1966 and stated that a meeting of representatives of the various supervisory agencies with representatives of the proposed holding company and Milwaukee Western Bank had been scheduled for Tuesday, September 6, in Chicago. The options in mind were to reopen the hearing record to introduce information concerning the condition of Milwaukee Western Bank or, in the alternative, to allow applicant an opportunity to withdraw the application. However, he had now received a telephone call from counsel for applicant asking that the Board take no action on the application until January or February of next year, by which time it was asserted that the condition of Milwaukee Western Bank would have improved substantially.

It was the consensus of the Board that the meeting next Tuesday should proceed as scheduled and that Mr. O'Connell should take the position that the hearing should be reopened unless applicant chose to withdraw its application.

Messrs. Harris, Smith (Legal), Burton, and Lyon then withdrew from the meeting.

Inflow of funds from foreign branches. Pursuant to previous request by the Board, there had been distributed several staff memoranda relating to the fact that foreign branches of certain U.S. banks had

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recently expanded greatly their holdings of Euro-dollar deposits and had been providing increasing amounts of dollars to their head offices.

In a memorandum of August 17, 1966, the Division of Research and Statistics (Mr. Fry) pointed out that in the six reserve weeks ended August 10 a few large member banks had increased their borrowings from their foreign branches by over \$900 million, which meant that the amount of such borrowings had nearly doubled and had reached a level of about \$2 billion. Such borrowings resulted in fractional releases of reserves in the U.S. banking system, and the excess reserves in turn supported expansion of domestic bank credit about equivalent to the increase in the borrowing from foreign branches. The memorandum described the process of credit expansion associated with increases in foreign branch borrowing, as well as the monetary policy implications.

In a memorandum of August 24 the Division of International Finance (Messrs. Katz and Grimwood) analyzed the growth of dollar claims in terms of their effect on the U.S. balance of payments. Under existing conditions of deficit in the balance of payments, they considered that it had been preferable to have Euro-dollar deposits utilized by head offices in the United States rather than to have them end up in the official reserves of a foreign country, which result would have been likely had the same dollars been used by London branches to make loans to corporations operating in foreign countries. In terms of the future, however, any substantial reduction of claims by London branches



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on U.S. head offices, except as they reflected the consequence of a reduced outflow of dollars from the U.S., would in all likelihood mean further additions to official reserves, especially of continental European countries.

In a memorandum of August 17 the Legal Division (Messrs. Hackley, Shay, and Forrestal) discussed the status of "liabilities" of U.S. banks to their foreign branches for reserve purposes. Among other things, the memorandum pointed out that in 1921 the Board had ruled that a balance "due" by the head office of a U.S. bank to its foreign branch, although shown as a liability on the books of the head office, did not constitute a deposit liability against which reserves must be maintained. It was believed that that ruling was sound and should not be reversed; any ruling by the Board that a bookkeeping liability of one office of a member bank to another constituted a deposit for reserve purposes would appear to be subject to legal attack. However, in 1918 the Board had ruled that while deposits in foreign branches of national banks were not subject to the reserve requirements of section 19 of the Federal Reserve Act, the Board had power under section 25 of the Act to prescribe reserves to be maintained against such deposits. The 1918 ruling was based on the ground that under section 25 the Board was authorized to permit the establishment of foreign branches of national banks upon such conditions and under such regulations as the Board might prescribe; and therefore the Board could determine the amount, character,

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and location of the reserves to be maintained against deposits received at such branches. To meet the present problem it was suggested that the Board could take the position that reserve requirements such as were generally applicable to member banks under section 19 should apply to deposits in foreign branches, but only to the extent that such deposits were contained in any balance recorded as a bookkeeping liability of the parent bank to the foreign branch. However, not all of the amounts reflected on the books of the parent bank as due to a foreign branch were necessarily deposit items; moreover, foreign branches apparently did not segregate the funds received as deposit liabilities from other funds received at the branch when funds were sent by the branch to the parent bank. Therefore, some formula for calculating the amount of deposits included in the balance due to the foreign branch would have to be used. Such a formula might be based on the ratio between deposits received at the branch and total funds received at the branch. It was believed that action, if taken, should be in the form of an amendment to Regulation M, Foreign Branches of National Banks.

Governor Robertson opened the discussion by suggesting that if the Board decided some action should be taken the Presidents of the Reserve Banks concerned might be asked to call in the heads of the member banks principally involved to discuss the situation and see whether the problem could be solved without drastic action. Should that effort fail, the Board could decide whether to proceed in some manner through regulation.

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Governor Brimmer said he was convinced that the Board ought to consider applying reserve requirements against these deposits. While the inflow of funds was helpful to the balance of payments, he did not think the assistance to the balance of payments outweighed the argument for subjecting the deposits to reserve requirements. Such action would serve to moderate the adverse impact on the domestic credit situation. He would suggest discussing the issue in terms of a proposal to take regulatory action, with the timing to be decided upon according to the Board's judgment as to when the impact could be absorbed without disruptive effects.

Governor Robertson then turned to Mr. Brill, who noted that the available figures indicated a continuing inflow of funds at a rate that, while lower than the initial burst of funds, was still substantial. In the period from midyear through August 10, there had been inflows of a little over \$900 million, and in the next two weeks approximately another \$150 million. Thus, the accumulation since midyear was a little over \$1 billion. As to the effect on the domestic bank credit situation, Mr. Fry's memorandum spelled out the staff interpretation. The inflow was providing funds to money center banks that had been hard pressed and were active in the business loan area, which was the area of most concern from the standpoint of fueling inflationary forces. From that standpoint, it would be helpful to see the inflow curtailed. As to the most appropriate manner, the Research Division did not have any position.



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A quiet approach directed to the handful of banks most actively concerned might be a way of limiting the inflow, and such an approach rather appealed to him on public relations grounds.

Mr. Katz pointed out that four banks accounted for about 70 per cent of the total. The inflow, he added, did have some effect on the balance of payments, as outlined in the memorandum from the International Finance Division. As to the outlook for this business, assuming no Board action, there were a lot of dollars available in the Euro-dollar market. Additional dollars were flowing into that market to the extent that there was a balance of payments deficit not settled through official transactions. The difficulty in making predictions derived from the high interest rate situation throughout the world, but with money tight here it seemed that U.S. banks should be able to obtain dollars from the Euro-dollar market at a price if they so desired.

Governor Robertson asked Mr. Katz if the latter had any quantitative estimate of the impact on the balance of payments, and Mr. Katz replied that he could not quantify.

Governor Mitchell observed that an avoidance operation could be involved, to the extent that deposits were placed in a foreign branch rather than the U.S. parent bank. The Board did not have any real basis for knowing how much of that was taking place.

Mr. Katz said bankers had told Board staff they definitely did not do that, but Governor Brimmer noted the existence of a report that

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an American bank had shifted \$128 million to a Japanese branch to avoid the earlier increase in reserve requirements. Mr. Fry said that according to the report, which came from a source in the New York Reserve Bank, the transfer was at the initiative of the American bank and was in the form of a time deposit. Mr. Katz pointed out, however, that the Japanese situation involved complicated arrangements and was not typical. The staff would have to get more details on the reported transaction in order to explain it fully.

Mr. Solomon expressed agreement with the view that the main problem was to try to weigh balance of payments considerations against the leakage in domestic credit restraint. He assumed that most of the shifted deposits were time deposits; if so, the 6 per cent reserve requirement should be applied to get some feel as to the reserve impact. On the basis of the July inflow, an evaluation was rather difficult. While it could not be said that monetary policy was undermined, a significant amount of reserves was involved.

There followed discussion of whether time or demand deposits appeared to be principally involved, according to different standards of definition, and it was agreed that further staff work would be required to obtain clarification.

Mr. Solomon went on to comment that the impact on the balance of payments seemed quite significant. To the extent that these funds were shifted home, they would not get into the hands of Europeans.

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This was an important aspect of national policy that ought to be weighed carefully, particularly at a time when the U.S. Government had been trying to induce people to change the form of their dollar holdings to make the balance of payments look better. It would not seem desirable to force U.S. banks to stop bringing the funds home, but instead to put a reserve requirement on them if something had to be done. That presumably would not make the funds so costly that U.S. banks would stop bringing them home altogether.

Governor Maisel cited what appeared to be a conflict between short-run and longer-run balance of payments objectives. He wondered whether the Board should not be quite concerned about the element of hot money. From the balance of payments standpoint, the question seemed to be whether the Board should give more weight to immediate statistics or the longer-run problem. He would personally prefer to seek long-run gains in preference to short-run statistical improvement.

Mr. Young commented that there was much to be said for that point of view. In the short run the inflow was helpful to the balance of payments, but at the expense of building up the problem of hot money. The funds brought in represented money almost subject to immediate withdrawal, so a substantial problem might develop if rate relationships shifted.

Governor Mitchell expressed the view that in principle deposits in foreign branches by U.S. corporations and nationals should be treated

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the same as deposits in the U.S. As to deposits in foreign branches by foreign nationals or corporations, that did have some different implications. But he could not see any reason for making it possible for a U.S. bank to say to its customer: Why not put the money in our foreign branch because there are no reserve requirements?

Governor Brimmer said that while he recognized the issue raised by Governor Maisel, and commented on by Mr. Young, he was willing to engage a little more in papering-over procedures that benefited the balance of payments. He was willing to run that risk. While he would not want to cut off completely the inflow of funds through foreign branches, he would make the procedure somewhat more costly for the banks. A reserve requirement should be applied if balances were shifted to the U.S. parent bank; once the funds got into the head office, they became domestic deposits and should be subjected to reserve requirements.

Discussion ensued regarding the possibility of a duplication of reserve requirements, that is here and abroad, on the same deposits, but staff expressed the understanding that there were no U.K. reserve requirements except for liquidity purposes, U.S. dollar obligations being excluded from the surveillance of the central bank.

After further staff comments on the composition of deposits at foreign branches, Governor Robertson turned to Mr. Hackley, who said it should be borne in mind that for almost 50 years it had been the position of the Board that deposits received in foreign branches were

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not subject to reserve requirements. While the validity of the 1918 ruling might be questioned, it had been followed since that time. However, the main problem was one of identification of funds. It would be simple if one could determine that a deposit made by a certain corporation in a foreign branch of a U.S. bank was actually shifted to New York, but that was not the case. Many types of funds were transferred regularly, and one problem was to identify the portion of those funds on the books of the parent office that represented deposits received at the branch. Another problem was to determine whether they were time or demand deposits. The Board apparently would have to resort to an arbitrary rule of thumb.

Mr. Shay agreed that the question was whether to try to establish some method of segregating the funds or whether to adopt some arbitrary rule that would seem reasonable enough to be acceptable. He was not sure that enough was known about the bookkeeping practices followed, and that might have a bearing on certain aspects of the whole problem under discussion.

Mr. Hackley noted that the operating problems apparently could be minimized if the Board proceeded on the assumption that under section 25 of the Federal Reserve Act it had authority to determine the amount and character of reserves to be maintained by foreign branches. The Board could then prescribe certain reserves to be maintained by foreign branches against their deposits without regard to the provisions of section 19.



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Mr. Forrestal said he had an uncomfortable feeling that not enough was known about the mechanics to form a sound judgment on a regulation at this point.

After further discussion along those lines, Governor Maisel said it was his impression that at the moment the Board did not have enough factual information to proceed intelligently. He would be inclined to designate a small staff task force to visit the banks principally concerned in New York and other cities, in company with appropriate Reserve Bank representatives, to discuss the whole problem and see how much they could learn about it, all with the objective of trying to ascertain what type of Board action might appear appropriate. No one had been authorized to say anything too specific up to this point, and he felt the Board should request the staff to undertake field visits promptly.

Governor Brimmer agreed, but expressed the hope that the staff would not limit itself just to learning things and instead would focus on the question of applying reserve requirements.

After further discussion it was agreed that the proposed staff task force should be formed and should visit the commercial banks concerned in company with appropriate Reserve Bank personnel, that the task force should proceed with this work promptly and report back to the Board by the week of September 12, if possible, and that Governor Robertson would alert the Reserve Banks concerned regarding the prospective investigation.

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Messrs. O'Connell, Shay, Forrestal, and Goodfellow then withdrew from the meeting.

Discount administration. A distributed memorandum from Mr. Holland dated August 29, 1966, advised that discount officers of the Federal Reserve Banks of New York, Philadelphia, and Chicago had that day met with members of the Board's staff in an endeavor to develop a practical program for adapting discount administration, insofar as possible, to the restraint of business lending. The results of the meeting were reflected in two drafts attached to the memorandum: (1) a program for discount administration in the current economic environment, and (2) a letter to member banks concerning the need to restrain business lending, the latter of which would be press released.

The discount officers had had at their disposal the original Board staff draft memorandum of August 19, 1966, on coordination of discount administration with other instruments of credit policy, along with a summary of comments at the August 23 meeting of the Board and the Reserve Bank Presidents and written comments received by the Board thereafter from several Presidents. However, they had elected to develop fresh language. They believed the program encompassed in the new draft documents went about as far as the System could feasibly go in adapting discount administration to the objectives the Board had expressed. In Mr. Holland's view, the program presented therein represented an effort in the direction of rebalancing credit pressures that

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might usefully be undertaken. It was suggested that copies of the documents be sent to the Presidents with a request for further comment.

A second distributed memorandum from Mr. Holland, dated August 31, submitted an alternative draft of the proposed letter suggested by President Hayes of the New York Bank, who wished to counter what he felt would be an adverse market impact from the original draft. Mr. Hayes felt that the highly unsettled state of financial markets, along with market expectations of a still tighter monetary policy, called for tranquilization by a moderate System statement. Mr. Holland's memorandum noted that other suggestions, in somewhat the same vein, had been received from members of the Board and staff, in reference both to the draft letter and the proposed internal System memorandum on discount administration.

Governor Robertson said he had received a telephone call from President Hayes expressing the view, as indicated in Mr. Holland's memorandum, that a System statement should be issued indicating concern about the rate of growth of business loans but endeavoring to allay any fears that the Federal Reserve discount window was going to be closed and that credit would not be available to provide for further growth of the economy as a whole.

Governor Robertson expressed the hope that the two draft documents could be redrafted promptly, in the light of comments already received and any offered at this meeting, so that revised draft documents,

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in form decided upon by the Board, could be wired to the Presidents no later than tomorrow with a request for comments, and action taken Friday.

Members of the Board then commented on the draft documents, with some members offering revised drafts of certain portions thereof, particularly the proposed letter, and views tended to consolidate sufficiently to provide guidance to Mr. Holland in preparing new drafts for the Board's review. Part of the discussion focused on the question whether the state of financial markets or the growth of business loans deserved greater emphasis, and there appeared to be general agreement that a blending of the two concerns should be reflected in the letter to the member banks.

It was understood that Mr. Holland would endeavor to prepare new drafts for the Board's consideration tomorrow.

The meeting then adjourned.

Secretary's Notes: A letter was sent today to Bank of America National Trust and Savings Association, San Francisco, California, acknowledging receipt of notice of its intent to establish an additional branch in Singapore, to be located in the High Street area. The letter noted that no capital investment would be required to establish the branch.

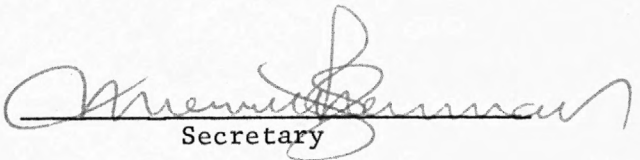
Governor Shepardson today approved on behalf of the Board the following items:

Letter to the Federal Reserve Bank of Kansas City (copy attached as Item No. 2) approving the appointment of Henry R. Czerwinski as Alternate Assistant Federal Reserve Agent.

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Memorandum from the Division of International Finance recommending acceptance of the resignation of James K. Nettles, Economist in that Division, effective September 6, 1966.

  
Secretary



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**TELEGRAM**

LEASED WIRE SERVICE

Item No. 1  
8/31/66

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON**

August 31, 1966.

WAYNE - RICHMOND

Board approves awarding of appropriate contracts for construction of new building for Communications and Records Center at Culpeper as described in your letter of August 26, 1966, and authorizes expenditure of approximately \$5,500,000 which figure includes architects' fees of \$321,256 and a contingency allowance of \$258,873.

(Signed) Merritt Sherman

SHERMAN

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BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

Item No. 2  
8/31/66

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD



August 31, 1966

AIR MAIL

Mr. Homer A. Scott,  
Federal Reserve Agent,  
Federal Reserve Bank of Kansas City,  
Kansas City, Missouri. 64106

Dear Mr. Scott:

In accordance with the request contained in Mr. Mathews' letter of August 24, 1966, the Board of Governors approves the appointment of Mr. Henry R. Czerwinski as Alternate Assistant Federal Reserve Agent at the Federal Reserve Bank of Kansas City, to succeed Mr. Donald L. Alexander.

This approval is given with the understanding that Mr. Czerwinski will be solely responsible to the Federal Reserve Agent and the Board of Governors for the proper performance of his duties, except that, during the absence or disability of the Federal Reserve Agent or a vacancy in that office, his responsibility will be to the Assistant Federal Reserve Agent and the Board of Governors.

When not engaged in the performance of his duties as Alternate Assistant Federal Reserve Agent, Mr. Czerwinski may, with the approval of the Federal Reserve Agent and the President, perform such work for the Bank as will not be inconsistent with his duties as Alternate Assistant Federal Reserve Agent.

It will be appreciated if Mr. Czerwinski is fully informed of the importance of his responsibilities as a member of the staff of the Federal Reserve Agent and the need for maintenance of independence from the operations of the Bank in the discharge of these responsibilities.

Please have Mr. Czerwinski execute the usual Oath of Office which should be forwarded to the Board of Governors along with notification of the effective date of his appointment.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,  
Secretary.