Minutes for September 27, 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 proposed to place in the record of policy actions required to be kept under the provisions of section 10 of the Federal Reserve Act an entry covering the item in this set of minutes commencing on the page and dealing with the subject referred to below:

Page 3 Increase in maximum permissible interest rate on loans made pursuant to Regulation V, Loan Guarantees for Defense Production.

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.

Chairman Martin

Governor Robertson

Governor Shepardson

Governor Mitchell

Governor Daane

Governor Maisel

Governor Brimmer

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, September 27, 1966. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Bakke, Assistant Secretary
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Harris, Coordinator of Defense Planning
Mr. Hexter, Associate General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Hooff, Assistant General Counsel
Mr. Smith, Associate Adviser, Division of Research and Statistics
Mr. Kiley, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Messrs. Forrestal, Sanders, and Via, Senior Attorneys, Legal Division
Messrs. Eckert, Chief, Banking Section, and Golden, Senior Economist, Division of Research and Statistics
Messrs. Egertson and McClintock, Supervisory Review Examiners, and Harris, Assistant Review Examiner, Division of Examinations

Approved letters. The following letters, copies of which are attached under the respective item numbers indicated, were approved unanimously after consideration of background material that had been made available to the members of the Board:

	Item No.
Letter to Wachovia Bank and Trust Company, Winston-Salem, North Carolina, approving the establishment of a branch in Charlotte.	1
Letter to Commercial and Farmers Bank, Ellicott City, Maryland, approving an investment in bank premises.	2
Letter to First State Bank, Bandera, Texas, approving an investment in bank premises.	3

Application of Upper Main Line Bank. There had been distributed a memorandum from the Division of Examinations dated September 15, 1966, regarding an application by Upper Main Line Bank, Paoli, Pennsylvania, for permission to merge with Farmers Bank of Parkesburg, Parkesburg, Pennsylvania, under the charter of the former and with the new name of Community Bank and Trust Company.

Following summary comments by Mr. Egertson based upon the Division's memorandum, the application was approved unanimously, with the understanding that an order and statement reflecting this action would be prepared for the Board's consideration.

Application of Brazil Trust Company. There had been distributed a memorandum from the Division of Examinations dated September 15, 1966, regarding an application by The Brazil Trust Company, Brazil, Indiana, for permission to merge with Farmers and Merchants Bank, Clay City, Indiana, under the charter of the former and with the new name of First Bank and Trust Company of Clay County, Indiana.

Following summary comments by Mr. Egertson based upon the Division's memorandum, the application was approved unanimously, with the understanding that an order and statement reflecting this action would be prepared for the Board's consideration.

Maximum rate of interest on V-loans (Items 4-6). The Defense Production Act of 1950 provided that agencies engaged in procurement for national defense may be authorized by the President to guarantee loans by financial institutions to persons engaged in any activity deemed by the agency to be necessary to expedite production and delivery or services under Government contracts. Implementing executive orders designated ten such agencies. The Federal Reserve Banks were named, as fiscal agents of the United States, to act on behalf of the guaranteeing agencies in making contracts of guarantee and in carrying out certain other functions, subject to the Board's supervision. Authority was vested in the Board (after consultation by the Board with the guaranteeing agencies) to promulgate necessary regulations and to prescribe, either specifically or by maximum limits or otherwise, rates of interest, guarantee and commitment fees, and other charges applicable to guaranteed loans. This regulatory authority was implemented by the Board in its Regulation V (Loan Guarantees for Defense Production).

In June 1966 the Board requested the heads of the guaranteeing agencies, as well as the Reserve Banks, for their views on whether the 6 per cent maximum rate of interest on guaranteed loans should be increased. Comment also was invited concerning whether the guaranteeing

agencies, which receive a percentage of the interest on the guaranteed portion of a loan, should share in the proceeds of loan rates in excess of 6 per cent if the ceiling were to be raised.

Responses indicated a consensus that an increase in the maximum rate of interest on V-loans to 7-1/2 per cent would be desirable, with the guarantee fee continuing to be computed as though the loan rate was 6 per cent in cases where the borrowing carried a higher rate of interest. The Defense Department's response also suggested a revision in the schedule of fees charged by the agencies to increase such fees on loans with guarantees of between 50 and 90 per cent, as an inducement for borrowers to seek lower percentages of guarantee. The effect of the suggested revision was doubted by the Board's staff.

At the Board meeting on August 11 the foregoing views were reported and it was agreed, following discussion, that before taking action the guaranteeing agencies and the Federal Reserve Banks should be advised of the Board's intention to raise the V-loan ceiling to 7-1/2 per cent (while retaining 6 per cent as the maximum rate for computation of guarantee fees) and their comments requested on the revision in guarantee fees recommended by the Defense Department.

There had now been distributed a memorandum from the Legal Division dated September 23 in which it was reported that: (1) the Department of Commerce and General Services Administration felt the schedule of guarantee fees should not be changed; (2) other agencies

had deferred to the Defense Department because of insufficient experience under the V-loan program; (3) the Department of Defense had advised informally that it would not object to maintaining the existing schedule of guarantee fees; and (4) the Reserve Bank comments received generally favored no change in the fee structure.

Attached to the memorandum were: (1) a draft of telegram to the Federal Reserve Banks advising that the Board had authorized an increase in the permissible interest rate ceiling on V-loans from 6 per cent to 7-1/2 per cent, that guarantee fees would continue to be computed on the basis of a maximum 6 per cent loan rate, and that no change was being made in the maximum commitment fee of 1/2 of one per cent or in the schedule of guarantee fees; (2) a draft of letter for transmittal to the guaranteeing agencies containing similar advice; and (3) a draft of press release announcing this action.

Governor Brimmer observed that while he recognized the reason for increasing the maximum permissible rate of interest on V-loans, namely, to improve the ability of defense contractors to obtain bank financing, he felt the timing was unfortunate because of the attention currently being focused on interest rate levels and the administrative steps taken last week, pursuant to recently-enacted legislation, to avoid further escalation of rates on time deposits and share accounts. In the circumstances, he believed that the press release should be prepared carefully to explain adequately the justification for this move with respect to V-loan rates.

Governor Robertson noted that the justification was clear. Since the present 6 per cent ceiling was unrealistic in present-day circumstances, an increase in the maximum permissible rate was necessary to encourage banks to participate in the V-loan program. On the other hand, he wondered whether a press release was necessary.

Mr. Fauver reported that a representative of the financial press had inquired several weeks ago about the possibility that the V-loan ceiling rate might be raised, thus indicating that the press would be alert for any action by the Board in this direction. Mr. Harris (Defense Planning) added that last summer the Office of Emergency Planning had requested that it be kept advised of developments, the question having come up in Congressional hearings whether defense contractors were being adequately financed. He felt that an appropriate press release would serve to make certain that the underlying motives for the V-loan action were clearly understood.

Governor Brimmer commented that the foregoing observations strengthened his conviction that a press release should be issued explaining fully the Board's rationale in this matter.

An increase in the maximum permissible rate of interest on V-loans from 6 per cent to 7-1/2 per cent was thereupon approved unanimously, effective immediately, with retention of the present ceiling of 6 per cent for purposes of calculating guarantee fees. Transmittal of advice of the action by telegram to the Reserve Banks and by letter to the guaranteeing

agencies was authorized. It was understood that the staff would prepare a press statement announcing the action and explaining the reasons therefor, taking into account the comments made during today's discussion, and release of such a statement was also authorized. Copies of the telegram sent to the Reserve Banks, the letter to one of the guaranteeing agencies, and the statement released to the press on September 29, 1966, are attached as Items 4, 5, and 6, respectively.

Cease and desist bill (Item No. 7). There had been distributed a draft of response to a request by Chairman Patman of the House Banking and Currency Committee in a letter dated September 19, 1966, for answers to 72 questions concerning subjects in the field of banking and credit, for the stated reason that such answers were needed by his Committee in connection with consideration of S. 3158, the so-called "cease and desist" bill.

Prior to consideration of the draft response, Governor Robertson reported on a meeting of representatives of the Federal bank supervisory agencies, the Home Loan Bank Board, and the Treasury Department that was held yesterday to discuss the pending legislation. He noted that the House bill reported by the Banking and Currency Committee in lieu of the Senate-passed version would authorize the agencies to exercise the cease and desist procedures for a period of about 18 months only, a provision that had been inserted by the Committee at Congressman Multer's request with the concurrence of Under Secretary of the Treasury Barr. Governor Robertson had pointed out at the meeting that that limitation would

seriously hamper the ability of the supervisory agencies to utilize the authority granted in the bill, and Under Secretary Barr had agreed to discuss the matter further with Chairman Patman.

It was also understood that Congressman Multer planned to offer a floor amendment to the reported bill to provide for something of a de novo hearing on the facts by the appellate court in lieu of judicial review of agency action thereunder. Governor Robertson commented that counsel for the supervisory agencies were collaborating in drafting language for Congressman Multer, to be submitted under cover of a letter expressing the view that the judicial review procedures specified in the Administrative Procedure Act, now under review by the Congress, would be more appropriate.

Finally, Governor Robertson observed that a provision to increase the Federal insurance on deposit and share accounts from $10,000 to $15,000 had been written into the House bill. The sentiment at yesterday's interagency meeting seemed favorable. However, if the 18-month limitation on the supervisory powers in the bill were retained, it would seem that the increased insurance coverage should also be limited to that period of time, since the broadened supervisory authority had been advanced as a justification for the insurance increase.

Discussion then turned to the draft of letter to Chairman Patman, during the course of which several suggested revisions were adopted. Unanimous approval was given to the transmittal of a letter in the form attached as Item No. 7.

Interpretation of action on time deposits (Item No. 8). There had been distributed a memorandum from the Legal Division dated September 26, 1966, presenting the question whether under the amendment to the Supplement to Regulation Q (Payment of Interest on Deposits) adopted effective September 26, 1966, a member bank must reduce the interest rate on existing time deposits, if in excess of the new maximum, if the deposit contract reserved the bank's right to reduce the interest in the event the Board should lower the maximum permissible rate below the contract rate.

Section 217.3(b) of Regulation Q provides that "No certificate of deposit or other contract shall be renewed or extended unless it be modified to conform to the provisions of this part, and every member bank shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to bring all of its outstanding certificates of deposit or other contracts into conformity with the provisions of this part."

Mr. Sanders noted that when the Board reduced the maximum permissible rate of interest on multiple maturity time deposits in July, the Supplement to Regulation Q adopted at that time made the new rates effective with respect to such a deposit "received on or after July 20, 1966," thus waiving the provisions of section 217.3(b) with respect to modification of outstanding contracts. However, the language of the Supplement issued effective September 26, 1966, coupled with the provisions of section 217.3(b), would require a member bank to exercise any

right that it might have to reduce the rate of interest on outstanding time deposits under $100,000 in order to conform to the maximum rates effective on or after September 26. The question presented was whether the Board wished to except such deposits from the new rate ceiling, as it had done at the time of the July action.

Mr. Sanders suggested that four alternative courses were open to the Board:

1. On the basis of a literal interpretation of Regulation Q and the current Supplement thereto, the Board might rule that a bank that had the right to conform its existing time deposit contracts, whether single or multiple maturity, to changes in the maximum permissible rates of interest should take whatever steps were necessary to do so beginning September 26.

2. The Board might continue its July policy of not enforcing the modification-of-contract requirement against outstanding multiple maturity time deposits that had been made before July 20, but enforce the requirements of section 217.3(b) against single maturity time deposits effective September 26.

3. The Board could announce that the new maximum rates would not apply to multiple maturity time deposits made before July 20, or to single maturity time deposits under $100,000 that were outstanding before September 26, thereby following the position taken by the Federal Deposit Insurance Corporation in announcing the applicability of its complementary regulatory action to deposits of nonmember insured banks.

4. The Board could amend Regulation Q to eliminate or modify section 217.3(b). The effect of that section on a deposit contract containing an automatic renewal clause but no clause permitting modification to conform to subsequent reductions in interest rate ceilings was not entirely clear. Furthermore, a member bank could now, consistent with the provisions of section 217.3(b), enter into a deposit contract with a single maturity of several years at the current applicable maximum permissible rate and, by not including a provision in the contract for conforming the rate to the Board's regulation, be obligated to pay the contract rate the entire life of the contract, even if interest rate levels and the maximums prescribed by Regulation Q should drop greatly.

Mr. Sanders recalled that a recommendation along the lines of the fourth alternative had been submitted to the Board in 1964 in connection with a proposed general revision of Regulation Q. It was now submitted again, both as a reasonable resolution of the questions that had arisen currently and as a change in Regulation Q that was considered desirable in any event.

Attached to the memorandum were drafts of press releases appropriate for announcing an interpretation embodying any one of the first three alternatives, and a draft of notice of proposed rule making suitable for publication in the Federal Register if the Board chose to amend section 217.3(b) of Regulation Q.

Governor Robertson stated that he would favor adopting the approach set forth in the third alternative and exempt time deposits that were outstanding before September 26 from the lower interest rate ceiling. That would be consistent with the Board's action in July and conform to the FDIC position. From the long-run point of view, however, he felt that it would be desirable to amend section 217.3(b) of Regulation Q, and he suggested that further consideration be given to this possibility at a subsequent time.

Mr. Fauver commented that it appeared that the general understanding by the press of the Board's current action was consistent with the interpretation proposed by Governor Robertson. He thought, therefore, that confusion might be minimized if the interpretation were simply to

be sent to the Reserve Banks for use in responding to inquiries from member banks, rather than to issue a press release on the subject.

There followed discussion of the Board's intent when the recent action was under consideration. Governor Robertson recalled having made the statement at that time that the action should not apply to outstanding contracts, and he understood the Board's conclusion to have been in that direction, which was consistent with the position taken in July with respect to multiple maturity time deposits. However, some member banks, upon reading the Board's press release, had been raising questions with their Reserve Banks, and it would seem desirable to confirm to the Reserve Banks--and through them to member banks--that the 5 per cent ceiling on time deposits under $100,000 did not apply to contracts entered into before September 26.

It was the consensus that no press release need be issued and that the questions that had been raised could be dealt with by a communication to the Reserve Banks. When some concern was expressed that unless the interpretation was sent to all member banks there could be lack of uniformity in their procedures, it was noted that the Reserve Banks could be requested to inform member banks in such manner as they believed appropriate.

Accordingly, the interpretation suggested in the third alternative was adopted unanimously, with the understanding that appropriate advice would be transmitted to the Reserve Banks. A copy of the wire subsequently sent to the Banks is attached as Item No. 8.

All members of the staff except Mr. Sherman then withdrew from the meeting and Messrs. Kelleher, Director, Division of Administrative Services; Kakalec, Controller; and Smith, Assistant to the Director, Division of Administrative Services, entered the room.

Utilization of outside space. Governor Shepardson presented to the Board alternative possibilities for the utilization by elements of the Board's staff of certain space outside the Federal Reserve Building if it should become available on a leased basis. The various possibilities were discussed, and it was understood that they would be explored in light of the comments made, with a view to further consideration of the matter by the Board at a subsequent meeting.

Messrs. Kelleher, Kakalec, and Smith then withdrew from the meeting.

Consumer credit (Item No. 9). Governor Robertson presented reasons why it appeared desirable to obtain through the Federal Reserve Banks certain current information with respect to consumer credit practices, and the Board then authorized the sending of a telegram to the Federal Reserve Banks in the form attached as Item No. 9.

The meeting then adjourned.

Secretary's Notes: Attached as Item No. 10 is a copy of a letter that was sent today to the Federal Reserve Bank of St. Louis approving a special Grade 16 maximum of $21,500 in the salary structure applicable to the head office, as requested in the Bank's letter of September 19, 1966. The letter was sent pursuant to the authorization given to the Secretary at the Board meeting on June 29, 1966.

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

Letter to the Federal Reserve Bank of Cleveland (copy attached as Item No. 11) approving the designation of 25 employees as special assistant examiners, as requested in the Bank's letter of September 21, 1966.

Letter to the Federal Reserve Bank of Richmond (copy attached as Item No. 12) authorizing the Bank to pay to the Retirement System of the Federal Reserve Banks the amount necessary to fund the cost of an increase in the survivor annuity of Mrs. Irene H. Flagg, widow of Maurice P. Flagg.

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

Appointments

Richard A. Williams as Chief, Equipment Operations and Production Control Section, Division of Data Processing, with basic annual salary at the rate of $17,721, effective the date of entrance upon duty.

Paul Goldstein as Production Control Supervisor, Division of Data Processing, with basic annual salary at the rate of $11,306, effective the date of entrance upon duty.

Agnes L. A. Zahra as Statistical Clerk, Division of Data Processing, with basic annual salary at the rate of $5,096, effective the date of entrance upon duty.

Transfer

Mary P. Barlow, from the position of Statistical Assistant to the position of Documentation Assistant, Division of Data Processing, with an increase in basic annual salary from $7,055 to $7,516, effective October 9, 1966.

Acceptance of resignations

John A. Marlin, Economist, Division of International Finance, effective October 7, 1966.

David G. Hayes, Economist, Division of International Finance, effective October 14, 1966.

Susan Herron, Clerk-Typist, Division of Research and Statistics, effective the close of business November 11, 1966.

Secretary

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

Item No. 1
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 27, 1966

Board of Directors,
Wachovia Bank and Trust Company,
Winston-Salem, North Carolina.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Wachovia Bank and Trust Company, Winston-Salem, North Carolina, of a branch on Sharon Road near its intersection with the planned Belk-Ivey Road, Charlotte, North Carolina, 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.)

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

Item No. 2
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 27, 1966

Board of Directors,
Commercial and Farmers Bank,
Ellicott City, Maryland.

Gentlemen:

Pursuant to the provisions of Section 24A of the Federal Reserve Act, the Board of Governors of the Federal Reserve System approves an additional investment in bank premises of not to exceed $320,000 by Commercial and Farmers Bank, Ellicott City, Maryland, for the purpose of constructing a new head office building. The approved expenditure is understood to include $50,000 for unforeseen costs and $20,000 for architect's fee.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

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

Item No. 3
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 27, 1966

Board of Directors,
First State Bank,
Bandera, Texas.

Gentlemen:

Pursuant to the provisions of Section 24A of the Federal Reserve Act, the Board of Governors of the Federal Reserve System approves an investment in bank premises of not to exceed $119,000 by First State Bank, Bandera, Texas, for the purpose of constructing a new head office building.

Very truly yours,

(Signed) Karl E. Bakke

Karl E. Bakke,
Assistant Secretary.

Item No. 4
9/27/66

TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

September 29, 1966.

To the Presidents of all Federal Reserve Banks

The Board, after consultation with the guaranteeing agencies, has authorized an increase in the maximum permissible rate of interest on V-loans from 6 to 7-1/2 per cent effective immediately. No change was made in the present maximum commitment fee of one-half of one per cent or in the schedule of guarantee fees now in effect. In those cases where the loan rate exceeds 6 per cent, the guarantee fee nevertheless is to be computed as though the loan rate was 6 per cent. It is suggested that you advise the interested financing institutions in your District of the Board's action.

In this connection, the Board is handing to the Press the following statement regarding the change:

HERE COPY "A".

(Signed) Merritt Sherman

Sherman

Item No. 5
9/27/66

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

September 29, 1966.

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

Dear Mr. Malloy:

This refers to the Board's letters of June 10 and August 15, 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 received from the guaranteeing agencies, the Board has authorized an increase in the maximum rate of interest on such loans from 6 per cent to 7-1/2 per cent effective immediately, with no change to be made in the maximum permissible commitment fee of one-half of one per cent or in the guarantee fees now charged by the guaranteeing agencies. The Board's action also provided that, in cases where the loan rate is in excess of 6 per cent, the guarantee fee should nevertheless be computed as though the loan rate was 6 per cent.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Item No. 6
9/27/66

For immediate release. September 29, 1966.

The Board of Governors of the Federal Reserve System, after consultation with the Department of Defense and other Government agencies that guarantee loans made by private financing institutions for the financing of defense contracts, has acted to raise the maximum rate of interest that may be charged for these special guaranteed loans (V-loans) authorized under the Defense Production Act.

No change was made in the existing schedule of guarantee fees. The Board's action also provided that in those cases where the interest rate on a loan is in excess of 6 per cent, the guarantee fee must continue to be computed as though the interest rate were 6 per cent.

The new maximum rate on V-loans is 7-1/2 per cent, but the net return to a lending institution is governed by the proportion of the loan that is guaranteed by the Government agency whose defense contract is being financed. For example, if a loan is 100 per cent guaranteed, the maximum net return to the lending institution will be 4.5 per cent after deducting the guarantee fee payable to the Government agency. A 90 per cent guaranteed loan will yield 5.9 per cent and a 75 per cent guaranteed loan will yield

6.8 per cent to the lending institution after guarantee fees have been deducted. Before this change, the maximum interest rate was 6 per cent, but after deducting the guarantee fee payable to the Government agency, a 100 per cent guaranteed loan netted a lending bank only a maximum 3 per cent; a 90 per cent guaranteed loan, 4.4 per cent; and a 75 per cent guaranteed loan yielded 5.3 per cent.

The action of the Board is designed to bring the net return to financing institutions on V-loans under this program more in line with current lending and money market rates and thus help to assure financing from commercial sources for contractors and subcontractors engaged in defense work.

Information received by the Board from the Federal Reserve Banks showed that the former ceiling rate, which had been in effect since 1957, provided a net return to financing institutions that had become increasingly noncompetitive with alternative loan and investment opportunities. As a result, the amounts disbursed under authorized V-loans dropped from $152 million in fiscal year 1964 to $119 million in fiscal year 1965, and $78 million in the year ending June 30, 1966, notwithstanding a substantial increase in military procurement.

Although originally a World War II measure, the V-loan program was revived by the Defense Production Act of 1950. From

September 1950 through June 1966 a total of 1,633 loans had been authorized amounting to $3.5 billion. Most of these loans were made during the Korean War period. The loans average approximately $2 million, and are primarily used by small and medium sized defense contractors having fewer than 500 employees. The income to the Government from the guarantee fees on authorized loans, after deduction of established and foreseeable losses, is in excess of $37 million.

Under provisions of the Defense Production Act of 1950, and implementing Executive Orders, designated procurement agencies of the Government[1/] are authorized to guarantee loans made by commercial banks and other private financial institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with, or in contemplation of, the termination of their defense contracts. The Federal Reserve Banks act as Fiscal Agents of the guaranteeing agencies in receiving applications for such credits and in the making of guarantee contracts.

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1/ The authorized guaranteeing agencies are the Departments of the Army, Navy and Air Force, the Defense Supply Agency, the Departments of Commerce, Interior and Agriculture, General Services Administration, the Atomic Energy Commission, and the National Aeronautics and Space Administration.

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

Item No. 7
9/27/66

OFFICE OF THE CHAIRMAN

September 28, 1966.

The Honorable Wright Patman,
Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C. 20515

Dear Mr. Chairman:

The following answers are furnished in response to the 72 questions enclosed with your letter of September 19, 1966, to which you indicated a prompt reply is needed in connection with consideration of S. 3158.

"Allocation of Credit"

"1. Under our fractional reserve monetary system our commercial banks create the vast bulk of the nation's money supply. Commercial banks enjoy a virtual monopoly on the creation of money and the allocation of credit through this mechanism.

What mechanism exists, if any, to insure prudent, effective and nondiscriminatory operation of this privately controlled system?"

Answer: In allocating credit in our economy, primary reliance is placed on competitive enterprise operating through a banking structure that features many thousands of banks competing with each other, with other financial institutions, and with the money and capital markets. Federal and State supervisory agencies help to ensure sound operations and to maintain a structure in which competition can spur more effective banking services. The Federal Reserve System endeavors to foster credit conditions under which the overall supply of credit and money can sustain economic growth without straining the capacity

of the economy. Allocation of that credit among particular borrowers is best accomplished by market forces, we believe, although we recognize that at times special efforts are needed to prevent a disproportionate share of total bank credit from flowing into one particular channel or another, e.g., business loans today, as indicated by the enclosed press release of September 1.

"2. What public controls exist by law or regulation to prevent undue concentration of credit channeled to large corporate customers of commercial banks which have close ties to such banks through interlocking directorships or other means?"

Answer: The Bank Merger Act and the Bank Holding Company Act and the procedures established under them are designed to preserve competition among banks and prevent undue banking concentration, thereby guarding against undue concentration of credit. Other provisions aimed primarily at maintaining sound banks, such as the limits on loans by banks to any one borrower, may incidentally also work against such concentration.

"3. On the other hand, what guarantees exist either through law or regulation that the credit needs of small business are met by commercial banks?"

Answer: No law or regulation guarantees that any particular borrower, large or small, will get a loan from a bank. Since most banks are small, they lend only to relatively small businesses. In recognition of the fact that smaller businesses may at times, however, have greater difficulty in obtaining funds than do larger businesses, the Congress has established special arrangements under the Small Business Act to help meet the credit needs of small businesses, by direct loans as well as by encouraging loans to small business by commercial banks and small business investment companies.

"4. Since the power to create money is sovereign--a prerogative of the public--what rights of appeal, if any, does a person have who is denied credit by a bank?"

Answer: No legal right of appeal exists, although a practical one does--the right to go to alternative sources of funds.

"5. Furnish the Committee whatever information available concerning the contention that large borrowers have a large portion of the available credit allocated to them."

Answer: One source of detailed information on this subject is the study made by the Board in 1958, a copy of which is enclosed. In addition, the Quarterly Financial Reports for Manufacturing Corporations prepared by the Federal Trade Commission and the Securities and Exchange Commission contain information on outstanding loans from banks by asset size of corporation. Over the current business upswing, it should be observed, smaller banks, which lend primarily to smaller businesses, have increased their commercial and industrial loans at a much faster rate than large banks. For example, between December 31, 1960 and December 31, 1965, these loans rose 59.5 per cent at reserve city banks compared with 73.5 per cent at country banks and 94.3 per cent at nonmember banks.

"6. Also furnish the Committee copies of all complaints from small business and individual borrowers you have received over the last five years."

Answer: While we have received letters commenting on the restrictive effects of monetary policy, incoming mail indicates a wider concern about developing inflationary pressures.

"Laws to Protect the Public Interest"

"7. Our commercial banking system indisputably is a public service industry, particularly as a result of its exercise of the public authority to create money. As such it is imperative that our banking laws protect the public right of access to available sources of credit and also protect the public's rights and interests as depositors.

What changes or additions to the present statutes, in your opinion, are necessary to protect the public interest in this regard?"

Answer: Recommendations for such amendments have been submitted to you from time to time. One of the most important of these is S. 3158.

"8. What shortcomings are you aware of in your agency and/or sister agencies in administering the banking laws to serve the public?"

Answer: We believe that the three Federal supervisory agencies are dedicated to the public interest and striving to carry out their responsibilities to the best of their ability. The extent to which these efforts have succeeded is better left to others to judge.

"9. Does there exist any conflict between your agency and other Federal or state banking supervisory agencies, either as regards existing law or regulations?"

Answer: As you know, there are a number of areas in which we have been unable to reach agreement with the Comptroller of the Currency, and we disagree with the Federal Deposit Insurance Corporation as to whether absorption of exchange charges constitutes the payment of interest on deposits.

"10. What criminal penalties are provided for violations of the banking laws your agency administers?"

Answer: Criminal penalties for violations of the laws administered by the Federal Reserve are listed below:

Subject	Provision of U. S. Code	Penalty
Foreign banking corporations	Title 12, § 617	Prison term of 1 to 5 years, or fine of $1,000 to $5,000 or both
	Title 12, § 630	Prison term of 2 to 10 years, plus fine up to $5,000
	Title 12, § 631	Prison term of up to 5 years, and fine up to $10,000
Director or officer serving after removal	Title 12, § 77	Prison term of up to 5 years, or fine of up to $5,000, or both
Bank Holding Company Act	Title 12, § 1847	Fine up to $1,000, per day for violation of Board's order or regulation; prison term up to 1 year, or fine up to $10,000, or both, for violation of any provision of the Act; officers, employees, et al, of a holding company are subject to prison term of up to 5 years, or fine of up to $5,000, or both, for false entries, per Title 18, § 1005

Bank securities registration, reports, etc. Margin requirements Borrowing to purchase registered securities	Title 15, § 78ff	Prison term of up to 2 years, or fine of up to $10,000, or both, except a fine not exceeding $500,000 may be imposed against an exchange
False entry to deceive examining authority	Title 18, § 1005	Prison term of up to 5 years, or fine of up to $5,000, or both
False statement or report to influence action of Reserve Bank on any application, loan, discount, etc.	Title 18, § 1014	Prison term of up to 2 years, or fine of up to $5,000, or both
Offer of fee for loan from Reserve Bank; acceptance of such offer	Title 18, §§ 214, 215	Prison term of up to 1 year, or fine of up to $5,000, or both
Offer of loan or gratuity to examiner; acceptance by examiner	Title 18, §§ 212, 213	Prison term of up to 1 year, or fine of up to $5,000, or both, plus a fine equal to the sum loaned or given
Wrongful issuance of currency by Federal Reserve Agent, et al	Title 18, § 334	Prison term of up to 5 years, or fine of up to $5,000, or both
False certification of check by Reserve Bank employee	Title 18, § 1004	Prison term of up to 5 years, or fine of up to $5,000, or both
Embezzlement by Reserve Bank employee	Title 18, § 656	Prison term of up to 5 years, or fine of up to $5,000, or both; but if less than $100, prison term of up to 1 year, or fine of up to $1,000, or both
False representation of membership in Reserve System	Title 18, § 709	Prison term of up to 1 year, or fine of up to $1,000, or both, for individuals; fine of up to $1,000 for business entities

Theft by examiner	Title 18, § 656	Prison term of up to 5 years, or fine of up to $5,000, or both; but if less than $100, prison term of up to 1 year, or fine of up to $1,000, or both; disqualified as examiner
Wrongful disclosure of information by examiner; performance by examiner of service for bank	Title 18, §§ 1906, 1909	Prison term of up to 1 year, or fine of up to $5,000, or both

"11. When a bank examiner discovers a suspected criminal violation, what formal reporting procedures are followed?"

Answer: Examiners for the Federal Reserve Banks are under instructions to report immediately all apparent or possible criminal violations which they discover to the vice president in charge of examinations of their respective Reserve Banks. Upon receipt of the details, the Reserve Banks report the offense to the local United States Attorney and forward copies of the reports to the Board's offices in Washington. Copies received by the Board are forwarded to the Department of Justice.

"12. Are all suspected criminal violations immediately reported to the U.S. Attorney, the Federal Bureau of Investigation, and the Department of Justice?"

Answer: Yes; however, the Reserve Banks do not report misdemeanors (for example, defalcations of $100 or less) if in their judgment it would not be desirable or serve any useful purpose to do so. Each Reserve Bank is required to preserve in its files a complete record of the facts and circumstances of each case not reported.

"13. How many criminal violations were reported by your agency in 1965?"

Answer: In 1965, the System reported to the Department of Justice 365 possible criminal violations involving State member banks. This included 94 robberies and 11 cases of larceny committed by persons other than bank employees.

"14. How many indictments and convictions were obtained on the basis of these reports?"

Answer: The System does not attempt to follow each offense reported to determine the final results of indictment or prosecution and, as a consequence, this information cannot be supplied.

"15. In 1965, how many officers, directors or employees of insured banks were removed from office for conviction of a criminal offense involving dishonesty or breach of trust? (See 12 U.S.C. 1829)"

Answer: Presumably, the question refers to that section of the Federal Deposit Insurance Act which provides that "Except with the written consent of the Corporation, no person shall serve as a director, officer, or employee of an insured bank who has been convicted, or who is hereafter convicted, of any criminal offense involving dishonesty or a breach of trust." As you know, this statute does not provide for removal of such persons and is directed primarily toward prevention of their employment by insured banks. In actual practice persons guilty of a criminal offense or even accused of a breach of trust frequently resign immediately from the bank. We know of no instance where it has been necessary to "remove" any officer, director, or employee so involved in the sense of ordering him to cease to serve. In the event an examination of a State member bank disclosed an officer, director, or employee in the service of the bank in violation of law, immediate action for their removal would, of course, be initiated by the System.

"16. Are you aware of any evidence of "organized crime" in banking? If so, state the extent of this involvement."

Answer: We have no evidence of extensive penetration of banking by "organized crime" although there have been occasional instances in which persons with criminal backgrounds attempted to misuse the assets of banks, such as those on which your Committee and the Senate Permanent Subcommittee on Investigations have recently held hearings.

"17. What checks are made by your agency to determine whether or not banks under your jurisdiction have been violating state usury laws?"

Answer: Our examination report form requires that the examiners ascertain the usual, highest, and lowest rates of interest on loans. Any violation of usury laws detected in the course of an examination is brought to the attention of the bank and a copy of the examination report is furnished to the State Banking Department. Since State law is involved, the State is primarily responsible for its enforcement.

"18. Cite all specific instances or cases in the last five years where action has been taken by your agency to protect the public interest as regards commercial banking operations under your jurisdiction."

Answer: The Board naturally believes that it is exercising its authority in the public interest at all times. We provide the Congress with an account of our actions each year in the form of an annual report.

"Examinations, Audits, and Reports"

"19. S. 3158, the so-called "cease and desist" legislation, if enacted, would require adequate examinations, audits, and reports on commercial banks.

How many field examiners does your agency employ, and how often are the banks under your supervisory jurisdiction examined by your agency every year?"

Answer: The question evidently refers to examinations of State member banks, which are made by examiners employed by the Federal Reserve Banks. This examination force averages about 450 men. State member banks are examined once a year, except where special circumstances call for additional examinations.

"20. Describe in detail the examination of bank trust departments."

Answer: There are enclosed a copy of the trust report of examination and a copy of the trust manual used by examiners for the Federal Reserve Banks. It is believed these will provide you with the procedures followed in the examination of bank trust departments.

"21. How many banks under your supervisory jurisdiction are audited each year by independent public accounting firms?"

Answer: We have no information on this question to add to that already obtained by your Committee's survey.

"22. What authority do you have to require independent audits of banks?"

Answer: No specific authority, although there is implied authority under some circumstances.

"23. Do you feel that there is need for independent audits of all commercial banks under your jurisdiction?"

Answer: The Board's views were furnished in our letter of July 28, 1965, a copy of which is enclosed.

"24. What reports are required to be filed with your agency by banks under your jurisdiction other than ordinary examination reports?"

Answer: State member banks are required to submit reports of condition (Form 105), reports of earnings and dividends (Form 107), and reports of changes in management or stockholdings (pursuant to Public Law 88-593). All member banks are required to furnish information needed for computation of required reserves (Form 414). Reports are also required from affiliates of State member banks (Form 220) and foreign banking corporations (Form 314). State member banks subject to the requirements of the 1964 amendments to the Securities Exchange Act of 1934 are also required to file annual reports (Form F-2), quarterly reports (Form F-4), and special reports needed to keep information previously filed on a current basis (Form F-3). In addition, a number of State member banks voluntarily cooperate with the Board by furnishing statistical information, both on a regular basis and in response to special surveys.

Question 25 is identical to question 24.

"26. How many reports did your agency receive in 1965 pursuant to Public Law 88-593, requiring notification to Federal banking agencies of changes in control of insured banks and loans secured by 25% or more of the voting stock of insured banks?"

Answer: During 1965, 57 reports were received pursuant to Public Law 88-593 indicating 35 changes in control of State member banks and 22 loans extended each of which were secured by 25 per cent or more of the voting stock of a State member bank.

"27. What rules or regulations have you promulgated to protect the interests of minority stockholders, and what comments do you care to make with respect to your experience under the Securities Acts Amendments of 1964, requiring certain commercial banks to make public information as to their operations?"

Answer: Enclosed is a copy of Regulation F, and the press release announcing its issuance. You will notice on page 4 of the press release reference to a deferred decision on provisions offering additional protection to minority stockholders. The Board expects to publish soon proposed revisions to the regulation incorporating such provisions. Experience thus far with the legislation indicates it is operating reasonably well, and we have no recommendations for changes in the statute at this time.

"28. In the two years since enactment of the Securities Acts Amendments, have you achieved your avowed goal of uniform financial reporting by commercial banks under your supervision?"

Answer: This question appears to be based on a misunderstanding. Uniform financial reporting by commercial banks subject to Federal Reserve supervision is not an "avowed goal" of the Board. As a part of its Regulation F, "Securities of Member State Banks" (12 CFR 206), the Board dealt with principles of financial reporting and prescribed certain general requirements with respect to such matters as accrual accounting, valuation and amortization of fixed assets, and consolidation of the financial statements of banks and certain of their subsidiaries. The Board's objective in this respect was and is to achieve, as far as practicable, comparability of financial statements of banks, in order that the investing public may make informed investment decisions. To a great extent, the Regulation and administration thereof have achieved such comparability. It must be borne in mind, of course, that more than 90 per cent of all State banks are not subject to the requirements of Regulation F or of the comparable regulations of the Federal Deposit Insurance Corporation.

"29. What additional statutory authority is required for you to carry out your responsibility with respect to examination, audit, and reporting requirements?"

Answer: As indicated in the letter referred to in answer to question 23, we feel there would be real merit in legislation specifically authorizing the Federal bank supervisory agencies to require outside audits in appropriate cases such as where internal controls are inadequate or have broken down. Enactment of S. 3158 would fill the need for "intermediate" powers with respect to supervision of banks.

"Agency Procedure -- Rights of Parties"

"30. What formal procedures are available as a matter of right to applicants for new charters, mergers or branches?"

"31. Are record hearings available?"

Answer: Refer to pages 24-29 of the Board's Rules of Organization and Procedure, a copy of which is enclosed. See particularly pages 24-26.

"32. Is judicial review available?"

Answer: Judicial review of Board procedures relating to and actions on applications for new charters, mergers, or branches is available. The sole chartering power of the Board exists with respect to corporations authorized to do foreign banking or financial business pursuant to section 25(a) of the Federal Reserve Act (12 U.S.C. 611 et seq.). Pursuant to section 25(a), the Board of Governors is empowered to issue a permit authorizing the applicant corporation to begin business. The authorizing statute contains no provision for judicial review. The Board interprets the judicial review provisions of section 10 of the Administrative Procedure Act as being applicable to the aforementioned function. Regarding merger and branch applications, while neither the Bank Merger Act (12 U.S.C. 1828(c) as amended by Public Law 89-356, February 21, 1966) nor the branch approval statute (12 U.S.C. 321) provides for judicial review of Board action, the Board has considered the judicial review provisions of the Administrative Procedure Act as being applicable to Board procedures as to both. Further, the Bank Merger Act contains a provision (12 U.S.C. 1828(c)(7)(A) through (D)) for the initiation by the United States Attorney General of judicial proceedings under the antitrust laws. In any such action, the trial court is authorized to review de novo the issues presented. Such a proceeding, of course, would constitute judicial review of Board action on a given merger application. Illustrative of the applicability of the judicial review provisions of the Administrative Procedure Act to applications for the establishment of branches by State member banks is the case of Old Kent Bank and Trust Company v. Wm. McC. Martin, Jr., et al., CA No. 1993-58, U.S.D.C. D.C.

"33. What provisions of the Administrative Procedure Act apply to your agency procedures?"

Answer: All provisions of the Administrative Procedure Act, mandatory, permissive, or exclusionary, are considered to be applicable to all procedures adopted by the Board in relation to its functions and operations.

"34. Are all requirements for the granting of charters, mergers and branches, or other actions published as a matter of record so that applicants may know precisely what is required to obtain approval?"

"35. Are all such regulations and requirements published in the Federal Register?"

Answer: Such regulations and requirements are set forth in the Board's Rules of Organization and Procedure, which is published in the Federal Register. Additional information is set forth both in specific applicable regulations, which are published in the Federal Register, and in application forms. Although such forms are not set forth in the Board's Rules of Procedure, the Rules include a list of such forms and a statement that they are available at the Reserve Banks.

"36. Are all interested parties invited to comment on proposed regulations and are public hearings always permitted parties in order to present their views on proposed regulations?"

"37. Do third parties have the right to participate in agency procedures concerning approval of a charter, merger or branch applications?"

Answer: Refer to pages 24-29 of the Board's Rules of Organization and Procedure, a copy of which is enclosed.

"38. Which of your records and documents are required by law to be kept confidential?"

Answer: No provision of law expressly requires the Board to keep any document confidential. There are special provisions relating to confidentiality of the examination process, such as section 1906 of title 18 of the United States Code and section 3(e)(8) of the Administrative Procedure Act, as amended by Public Law 89-487. Section 30 of the Banking Act of 1933 requires confidentiality in connection with removal proceedings.

"39. What records and documents do you keep confidential from the public as a matter of administrative practice?"

"40. Have you published any rules or regulations providing for the confidentiality of records and documents and reports filed with your agency?"

"41. What records, reports and documents are not confidential?"

"42. Are these reports, records, and documents readily available for public inspection?"

Answer: The answers to these questions are set forth in the Board's Rules of Organization and Procedure, a copy of which is enclosed, at pages 13-19.

"43. Do you maintain facilities for public inspection of documents as does, for instance, the Securities and Exchange Commission?"

Answer: Facilities are maintained for public inspection of registration statements and reports filed by State-chartered insured banks, both member and nonmember, under the 1964 amendments to the Securities Exchange Act. Requests to examine other papers available for inspection are not received often enough to warrant maintenance of special facilities for that purpose, but such facilities are made available as needed.

"44. Is informal ex parte contact between officials in your agency and parties seeking charters or other approval permitted, or are all discussion and contacts committed to writing and made a permanent part of your files?"

Answer: In many instances informal contact between Board personnel and parties seeking Board approval of proposed transactions precedes formal submission of an application. In such cases, the potential applicants are directed to published sources of information concerning Board requirements with respect to such applications. To the extent warranted, written notations or memoranda are made of such informal contacts. Once an application has been filed, discussion and contacts between Board officials and applicants are, within reasonable limits, committed to writing and made a permanent part of our files.

"45. Have any employees of your office in recent years who were processing charter or merger applications been offered employment or been subsequently employed by such applicants?"

Answer: The Board cannot, of course, be certain that all offers of employment of the nature described have come to its attention. The Board is unaware of an instance where an offer of employment to a Board employee in the position above described has resulted in employment by such an applicant. The Board understands that a former member of the Board's legal staff was retained, subsequent to his return to private practice, by such an applicant. As far as the Board is aware, in no instance of employment or offer of employment has there been presented a possible conflict of interest.

"46. What rules of conduct have you published with respect to agency employees?"

Answer: Rules governing "Employee Responsibilities and Conduct" were published in the Federal Register on March 5, 1966. A copy is enclosed.

"47. Are your employees permitted to participate in union activity, including the organization of unions?"

Answer: Yes.

"48. Do you know of any cases where employees of your agency were discriminated against because of union activity?"

Answer: No.

"49. Are your employees under the "classified" civil service?"

Answer: No.

"50. Do officials and employees of your agency customarily socialize with people of the banking industry?"

Answer: Board officials and employees often attend social gatherings at which bankers are present.

"51. I quote from a Banking and Currency Committee staff analysis entitled "Audits of Banks by Public Accountants." This was prepared for the Subcommittee on Domestic Finance and released March 22, 1966.

> "The actions and policies of the three bank supervisory agencies suggest a conspiracy of concealment among the supervisory agencies and the banks which they are legally responsible for regulating. Simple requests addressed to the supervisory agencies for financial information regarding commercial banks get the standard response of 'Sorry, but that is confidential information.'"

Is there anything in S. 3158 which would cure the secrecy problem cited in this staff analysis?"

Answer: Such requests are not met with a standard response that the information is confidential. Some requests are, where the information requested is confidential. Nothing in S. 3158 would affect this situation.

"Political Activity, Restraint of Trade and Self-Dealing by Banks"

"52. In recent months, there has been much publicity about contributions by banks, bank officers, and directors to various political candidates.

Have any of the bank supervisory agencies investigated any of these public charges and, if so, what have been the findings?"

Answer: No such investigation has been made by the Board.

"53. If you have not investigated these published reports of political activities by banks and bank officials, would you explain why not?"

Answer: Nothing has come to the attention of the Board that appeared to warrant any special investigation. Federal law does not preclude individuals from engaging in political activities simply because they are connected with banks. Action by the Board would be authorized only where a State member bank has made a contribution to a political party or candidate in violation of 18 U.S.C. 610. Any such violation disclosed in the examination of a State member bank would be reported as described in the answer to question 11.

"54. Would you, under S. 3158, investigate charges of political activity by banks and bank officers?"

Answer: Under any applicable statute, including S. 3158, the Board would initiate appropriate investigation of charges of prohibited political activity by a member bank.

"55. To what extent has your agency investigated the use of bank funds for lobbying activities on pending legislation before state and national legislatures?"

Answer: No such investigation has been made.

"56. Would you broaden your investigation of lobbying activities and lobbying expenditures under provisions of S. 3158?"

Answer: No.

"57. The pending bill provides for removal of bank officials under certain circumstances.

Would such circumstances include collusion between the bank and a customer of the bank designed to freeze out other business enterprises in a community? For example, would this legislation cover a situation where a bank official entered into an agreement with a local manufacturer to refuse loans to the manufacturer's competitor?"

Answer: Suspension or removal orders could be issued only in cases involving, among other things, personal dishonesty; this element would not seem to be present in the example given.

"58. The Subcommittee on Domestic Finance of the Banking and Currency Committee is carrying out a survey of commercial bank stock ownership. One question being looked into is the extent to which banks use their trust departments to purchase bank stock, both of their competitor's as well as stock of the trustee bank.

Would you regard such purchases as a sound banking operation?"

Answer: We would not regard all such purchases as unsound per se. It would depend on all the circumstances and conditions surrounding the transaction. As indicated by the Board's former regulation on the exercise of trust powers by national banks (which was terminated September 28, 1962, when authority to issue regulations on that subject was transferred to the Comptroller of the Currency), the Board believes that purchase of a bank's own stock by its trust department should be limited to cases where it is expressly required by the trust instrument or specifically authorized by court order.

"Coordination"

"59. One of the serious questions that has been raised a number of times in the last few years in regard to supervision of banks by the three Federal bank supervisory agencies is the question of coordination of activity between these three agencies and between them and the Justice Department. I regard this as a serious problem.

What, if anything, in the proposed legislation would help to solve this problem of coordination?"

Answer: Nothing.

"60. What would prevent agencies under this proposed law from issuing regulations which would provide different criteria for the application of this law to the three different sets of banks under the examination and supervisory authority of the three Federal bank supervisory agencies?"

Answer: See answer to question 65.

"61. If the three agencies ever issue different criteria and different regulations for the application of this proposed law, doesn't this mean unequal treatment for the three sets of banks?"

Answer: Yes.

"62. If one of the Federal agencies issued rather loose regulations and another issued strict, there would be discrimination in the treatment of different banks by agencies of the Federal Government. Do you think this is fair?"

Answer: No.

"63. What criteria exists by which your agency will judge whether or not a "cease and desist" proceeding will be undertaken?"

Answer: At the present time, the only criteria are those specified in the bill.

"64. Will these criteria be published in the Federal Register?"

Answer: It seems unlikely that any formula could be devised for publication that would cover all circumstances. In fact, one of the arguments that has been advanced in favor of the bill is that it will enable problem cases to be solved on an individual basis, thereby lessening the need for a proliferation of published regulations.

"65. How will your agency coordinate its activities under S. 3158, assuming enactment, with the other two Federal banking regulatory agencies?"

Answer: In the same way that we now endeavor to coordinate our other activities, that is, through discussions and conferences between Board members and staff and the heads and staffs of other agencies, as well as through the Coordinating Committee on Bank Regulation. Obviously, this process will not assure complete agreement.

"66. Is it not possible for each of the agencies to use criteria which will discriminate against a bank under the jurisdiction of one of the other agencies?"

Answer: Yes.

"67. Would it not be more appropriate to have the three banking agencies develop a single set of criteria that would be applicable to all commercial banks regardless of the individual agency to whom a given bank were responsible?"

Answer: This is a most desirable goal and we will continue our sincere efforts to achieve it. Under the present statutory division of responsibilities, however, there can be no guarantee that the effort will succeed.

"68. Would it not be more equitable to have one administrative procedure hearing in the nature of a court for all agencies involved so as to insure uniform application of the law?"

Answer: Uniform application of the law can best be assured, in our judgment, through unification of responsibility for administering the law.

"Overly Complex Criteria in S. 3158"

"69. The provision of the proposed bill, S. 3158, providing for the removal of an officer or director depends upon the interrelation of a number of factors. Before action may be taken against an officer or director, he has to have (1) violated a provision of law, rule, regulation, or final cease and desist order, or (2) engaged in an unsafe or unsound practice, or (3) breached his fiduciary duty as a director or officer, and (4) as a result of such violation or breach of duty the institution must suffer or will probably suffer substantial financial loss or other damage, or (5) the interest of depositors must be seriously prejudiced by such violations or breach, and (6) such violation, practice, or breach of duty must be one involving personal dishonesty.

Is it really necessary that this provision of the proposed law be so complex and involve the pyramiding of so many different criteria before an agency can take action?"

Answer: No. Like many statutory provisions, this is the product of much negotiation among interested parties involving a number of compromises. One such compromise is the provision limiting application to cases involving personal dishonesty. The Board has reservations about this limitation, but has accepted it in the belief that the suspension and removal provisions of the bill are less important, insofar as State member banks are concerned, than the provisions regarding cease and desist orders, and that any deficiencies in the former are outweighed by the benefits to be gained from the latter.

"70. Since this provision is so complex, can it be effectively administered?"

Answer: We believe that it can, although it is likely to be invoked rarely, insofar as State member banks are concerned.

"71. Wouldn't it be sufficient for the bill to provide for the service of a notice of removal on an officer or director upon a finding of violation of law, rule, regulation, or final cease and desist order which involves a breach of fiduciary duty of such officer or director?"

Answer: This simpler provision would, of course, greatly expand the Board's authority. Naturally, we believe that we would administer it with discretion and would not abuse it. Just as naturally, the institutions that would be subject to it have much greater doubts about how it would be administered and oppose giving the Board that much leeway.

"72. If this is not acceptable, what alternative less complex criteria do you recommend?"

Answer: As indicated above, the simpler provision would be acceptable to the Board.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

Item No. 8
9/27/66

TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

September 28, 1966.

Presidents, all Federal Reserve Banks.

Question has been raised whether Board's action of September 21, reducing from 5-1/2 per cent to 5 per cent maximum rate of interest payable by member banks on time deposits of less than $100,000, requires a reduction as of the September 26 effective date in interest rates being paid on certificates of deposit and other time deposits outstanding before that date.

Board has responded that a member bank may continue to pay on deposits outstanding before September 26, 1966, the rate of interest that it was paying immediately before that date. If it either has reserved the right to reduce the rate of interest in the event the Board of Governors lowers the maximum permissible rate below the contract rate or has the right to terminate the deposit upon specified notice, it may, but need not, do so. When a contract is entered into on or after September 26, 1966, the rate of interest may not exceed the new ceiling.

This is consistent with the position taken by Board in its action of July 15, 1966, with respect to maximum rate effective July 20 on any multiple maturity time deposit.

Board is not issuing press statement on subject of this telegram but suggests that member banks in your District be informed of its substance in such manner as you believe to be appropriate.

(Signed) Merritt Sherman

Sherman

Item No. 9
9/27/66

TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

September 27, 1966.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

The Board needs certain information in the consumer credit field, as part of its continuing evaluation of the impact of monetary policy on the credit markets. Brill has been in touch with the Heads of Research to alert them to the general plan; this telegram spells out the details. Board needs are twofold: (1) some general impressions about lenders' standards and the availability of funds for financing consumer purchases, and (2) specific data on presently prevailing terms on consumer instalment loans. The Board would appreciate your conducting a spot survey of a small number of consumer credit lenders and venders in your city to obtain this information. The survey will cover regular instalment contracts, not revolving credit.

First, as to general impressions about the consumer credit market, you will probably want to ask the lenders such questions as: (1) Are their lending standards for consumer loans noticeably tighter than, say, six or eight months ago? (2) If so, what policies have changed? What types of loans have been affected? (3) Have they turned down a larger than usual number of credit applicants in recent months? (4) Have their interest charges on consumer loans changed during this period? (Get a few examples). (5) In the case of finance companies or merchants, have they experienced any great difficulty in obtaining funds for consumer lending? (6) In the case of banks, has management sought to curtail or ration the amount of funds made available for consumer lending purposes?

The second part of the survey will deal with data on non-auto consumer loans. (Terms on auto loans are included in the material your Bank regularly furnishes to the Consumer Credit Section.) To the extent possible, the data should be based on actual consumer loan records at banks, sales finance companies, consumer finance companies, credit unions, and retailers, rather than statements of company policy on lending terms, which often differ from the actual prevailing terms of transactions. For each of the loan categories listed below, please obtain about 50 random observations of recent loans. These can be distributed among the various lenders more or less as you see fit, although consideration should be given to the relative importance in your District of the various lenders in the different loan categories. The loan categories are (1) furniture, (2) major household appliances, radio, television, (3) boats, trailers, mobile homes, (4) home improvement (excluding mortgage loans), (5) education, and (6) all other personal loans. The information wanted for each loan is (1) purpose (you should be specific, e.g., "refrigerator"--we will classify), (2) face amount of note (including finance and other charges), (3) downpayment (including trade-in allowance), (4) maturity in months, and (5) lender (bank, retailer, etc.)

Thus, each Reserve Bank is to supply data on 300 separate loans. This can probably be most efficiently accomplished by completing a short form for each loan, such as the one below:

3637

Federal Reserve District Number _____ Date_____

Consumer Loan Survey

(1) Purpose:

(2) Amount:*

(3) Downpayment:*

(4) Maturity:

(5) Lender:

* Omit cents.

Please summarize the answers to the general questions in a two or three-page statement and mail it, along with the completed forms, to Orville Thompson in the Research Division. These materials should reach him no later than Wednesday, October 5. Questions may be directed to Thompson.

(signed) Sherman

SHERMAN

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

Item No. 10
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 27, 1966.

CONFIDENTIAL (FR)

Mr. Darryl R. Francis, President,
Federal Reserve Bank of St. Louis,
St. Louis, Missouri. 63166

Dear Mr. Francis:

The Board of Governors has approved a special Grade 16 maximum of $21,500 in the salary structure applicable to the Head Office of the Federal Reserve Bank of St. Louis, effective immediately, as requested in your letter of September 19, 1966.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 11
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 28, 1966

Mr. Harry W. Huning, Vice President,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio. 44101

Dear Mr. Huning:

In accordance with the request contained in your letter of September 21, 1966, the Board approves the designation of the employees indicated on the list enclosed with your letter as special assistant examiners for the Federal Reserve Bank of Cleveland.

Appropriate notations have been made of the names to be deleted from the list of special assistant examiners.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.

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

Item No. 12
9/27/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 28, 1966

Mr. Edward A. Wayne,
President,
Federal Reserve Bank of Richmond,
Richmond, Virginia. 23213

Dear Mr. Wayne:

The Board of Governors has recently approved incorporating into the Board of Governors Plan of the Retirement System of the Federal Reserve Banks certain provisions of Title V of Public Law 89-504. Section 507 of this Title increases the annuities of surviving spouses of deceased members who retired or died prior to October 11, 1962 by 10 per cent. This adjustment became effective September 1, 1966.

In order that the widow of Maurice P. Flagg may continue to receive the same benefits that would have been payable under the Board Plan, as outlined in Mr. Leach's letter of September 9, 1955, the Board of Governors authorizes the Federal Reserve Bank of Richmond to pay to the Retirement System of the Federal Reserve Banks the amount necessary to fund the cost of this increase in Mrs. Flagg's survivor annuity.

It is understood that the Retirement Office will bill the Bank for the cost of funding this benefit.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

cc: Mr. Martin W. Bergin,
Secretary, Retirement System of
the Federal Reserve Banks,
Federal Reserve Bank of New York,
New York, New York. 10045