

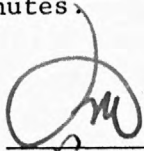
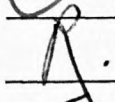
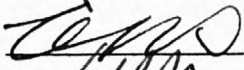
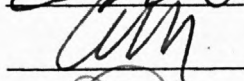

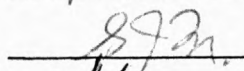
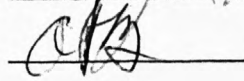
Minutes for October 7, 1966

To: Members of the Board
From: Office of the Secretary

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

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

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

Chm. Martin	
Gov. Robertson	
Gov. Shepardson	
Gov. Mitchell	
Gov. Daane	
Gov. Maisel	
Gov. Brimmer	

A meeting of the Board of Governors of the Federal Reserve System with an Ad Hoc Committee of the Trustees of the Retirement System of the Federal Reserve Banks was held at the Federal Reserve Building in Washington, D. C., on Friday, October 7, 1966, at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Johnson, Director, Division of Personnel Administration
Mr. Hexter, Associate General Counsel
Mr. Hart, Assistant Director, Division of Personnel Administration

Messrs. Swan, Wayne, Smith, and Moody, Members of the Ad Hoc Committee 1/

At their meeting in June of this year the Board of Trustees of the Retirement System of the Federal Reserve Banks noted that on July 19, 1965, the Chairman of the Retirement Committee had addressed a letter to the Board inquiring whether the Board would approve in

1/ Mr. Swan became Chairman of the Board of Trustees of the Retirement System earlier this year, and Mr. Wayne was serving as Chairman of the Executive Committee. Messrs. Smith, Assistant Vice President of the Federal Reserve Bank of New York, and Moody, Vice President in charge of the Nashville Branch, Federal Reserve Bank of Atlanta, were trustees elected by the employees of their respective Banks. The fifth member of the Ad Hoc Committee, Mr. Galusha, an ex officio trustee, was unable to be present at this meeting.

10/7/66

-2-

3774

principle a proposed plan for distribution of earnings not required for actuarial purposes and reserve accounts, that no reply had been received to that inquiry, and that the disposition of the proposal could have an effect on possible future changes under the Bank Plan of the Retirement System. Accordingly, the Trustees requested their new Chairman (Mr. Swan) to seek an audience with the Board at which a small committee could discuss the pending proposal and other possible areas of study or action and communicate to the Executive Committee the outcome of the discussion. The Executive Committee would then have the responsibility for studying a further course of action, which might include the questions of early retirement without full actuarial discount, supplementation of allowances of retirees, particularly by reason of cost-of-living increases, and a possible shift to a non-contributory plan.

In introductory comments, President Swan said that the Ad Hoc Committee would like today's discussion to encompass as broad a spectrum as possible in terms of attitudes and possibilities for further action, rather than to have it limited solely to the question of distribution of excess earnings. The general desire was to achieve the best possible retirement system, one that was appropriately competitive.

Chairman Martin said that the Board also would like to have a wide range of discussion. He then turned to Governor Maisel as the Board-appointed member of the Board of Trustees of the Retirement System and asked the latter for his impressions regarding current problems.

10/7/66

-3-

Governor Maisel said he saw three main types of problems. First, there was the question what the benefits under the Retirement System should be and how the beneficiaries should make known their desires. Once the beneficiaries had made known their desires, the next question was how the Board of Governors and the Boards of Directors of the Reserve Banks should evaluate the situation in terms of cost and what the System should do. This was particularly difficult because of the quasi-governmental nature of the Federal Reserve Banks. On one side, there was the question of competitiveness with local private firms, which encompassed the whole area of salary structures and fringe benefits. On the other side, there was the question of competitiveness with governmental benefits such as provided under the Civil Service Retirement System. As he understood it, the conflict thus involved had never been thought through fully. A further major problem involved in the proposed distribution of earnings was the investment concept of the retirement fund, given the fact that the Treasury was the residual claimant on earnings of the Federal Reserve System. The Retirement System trustees were called upon, under the existing format, to deal with the return on stocks and bonds, whereas the System's major responsibility was for the monetary policy of the country. This raised the question whether some conflict of interest might be involved. In the eyes of the participants there might be no conflict, but that might be hard to explain to outside parties convincingly. Therefore, this

10/7/66

-4-

3776

subsidiary problem entered the picture when the question came up of increasing Retirement System benefits through the distribution of earnings.

Chairman Martin then turned to Mr. Smith, who noted that one question was whether or not to improve the Retirement System benefits, while another was whether to distribute excess earnings. The questions were not entirely interdependent, although the earnings could be used to pay for increased benefits.

Mr. Smith went on to say that the employees of the New York Bank were more knowledgeable about the Retirement System than a decade ago, and there was a feeling among them that the employees had a vested interest in the earnings on the sums they had contributed. He felt sure there would be a fairly widespread feeling, absent any distribution of excess earnings or identifiable improved benefits, that the employees were being deprived of earnings on money they had been required to contribute to the Retirement System. If the excess earnings simply went to reduce the Reserve Banks' actuarial liability, that would create a morale problem, for the employees would feel that such use of the earnings on their contributions was not fair. He knew that to be the attitude of many employees of the New York Bank. If there were changes in the basic concept of the Retirement System--for example, if it were shifted to a noncontributory basis--or if the benefits were increased in such a way that the employees could be told that the

10/7/66

-5-

3777

excess earnings were being used to buy in part certain additional benefits, then he felt that an explanation should not be too difficult. But there was a strong view that the earnings should in some way enhance the employees' position and not be used for the benefit of the Reserve Banks.

After noting that Mr. Smith had stated the matter well, Chairman Martin turned to Mr. Moody, who expressed the view that the main questions could be resolved either through some distribution of excess earnings or some change in retirement benefits. Perhaps the most pressing problem was that of providing additional income for retirees because of increases in the cost of living. There were also the questions of allowing early retirement without full actuarial discount and of providing some increase beyond 3-1/2 per cent in the guaranteed rate of return on employees' contributions.

Governor Shepardson noted that from time to time there had been improvements in the benefits provided under the Retirement System. However, some little time had elapsed since the last adjustment was made, and it would appear that there should be a means of adjusting to take account of cost-of-living changes. Such an adjustment should, in his view, meet the argument of employees that they were entitled to part of the earnings on funds they had contributed.

10/7/66

-6-

3778

Governor Shepardson then called attention to the percentage of salary contributed by employees under the Civil Service Retirement System (and the Board Plan of the Federal Reserve Retirement System), such percentage being substantially higher than the rate contributed by employees under the Bank Plan. This had a bearing on the question of comparability of the benefits under the Bank Plan with Board-Civil Service on the one side and private local industries on the other. In other words, it was necessary to look at the whole package. The Board had taken the position, in the area of salary administration, that salaries at the Reserve Banks should be geared to the competitive local market. Once that position was taken, it must also be borne in mind in making the statement that benefits under the Civil Service Retirement System had a little edge on benefits under the Bank Plan. If the Reserve Banks were to be compared with Civil Service as far as retirement benefits were concerned, then it would seem to follow that the comparison should also be extended to salary structures.

Governor Shepardson concluded by expressing the view that some improvement in retirement benefits would seem preferable to a distribution of excess earnings.

President Swan observed that it was not possible for Reserve Bank retirement benefits to be fully competitive with the retirement plans of private firms because the latter were able to offer as parts of their retirement program features such as profit-sharing

10/7/66

-7-

3779

and stock purchase options. However, it did appear that the gap could be narrowed, to some degree at least, through provision for early retirement without full actuarial discount.

Mr. Johnson mentioned that the Actuary for the Retirement System was at present being asked to make a further study of certain fringe benefits, and some of the questions raised today probably would be included in that study. He had thought that provision for early retirement without full actuarial discount would be recommended by the Retirement Committee when an earlier study of benefits was made. At that time, however, the Actuary found that most private firms were not providing such an option, and that finding apparently influenced the thinking of several members of the Committee. Possibly the situation had now changed; the forthcoming study would probably disclose whether such was the case.

There followed references to previous occasions on which adjustments in Retirement System benefits had been made and the nature thereof, after which President Wayne commented that he could see the possible difficulty involved in explaining to outsiders the position of members of the Investment Committee of the Retirement System. That went principally to the question of the Retirement System's administrative structure rather than to employee benefits. He would consider it desirable for the Executive Committee to take a look at that question, for if it was felt that a conflict of

10/7/66

-8-

interest was implied, that could involve fundamental changes in the nature of the investment program. One possibility would be to turn to the position advocated by former Chairman Eccles many years ago and invest all of the funds of the Retirement System in long-term Governments, thus eliminating the element of investment discretion. If it was thought that a significant problem existed in this regard, involving relationships with the Congress and others, the matter should be reviewed carefully, including the use of a private firm as consultant to advise the Retirement System on investments.

President Wayne then noted the earlier comment by Governor Shepardson that in the latter's opinion it would be unwise to use the reserves that had been built up to make a distribution of earnings, and that it would seem advisable to look at the Retirement System benefits in relation to the appropriate competitive market, with the question of how they should be financed then to be considered as a residual matter. If that represented the consensus of the Board of Governors, it would suggest that the proposal for distribution of earnings be laid on the table while a completely new look was taken at the Retirement System in order to decide what should be done. The question came back, then, to the problem of the competitive market against which comparisons should be made.

The most significant recent development, President Wayne observed, was the amendment to the Social Security program, with the result that beginning this year no contributions to the Federal

10/7/66

-9-

Reserve Retirement System any longer were made by employees with salaries up to \$6,600 (rather than \$4,800). That meant that 82 per cent of the total staff of the Federal Reserve Banks was now under a noncontributory system except with respect to Social Security. It also suggested possible vulnerability to outside criticism because of the fact that the remaining 18 per cent included the personnel in the upper salary brackets, but at the same time that was the area of most intense competition with the private market. He was not sure that the Federal Reserve could ever hope to compete evenly with the private market in the area of retirement benefits, but certainly there was a need to review the situation. He would also suggest taking a look at the question of shifting to a non-contributory plan, which might mean an ultimate dismantling of the Present Retirement System and abandonment of annuities altogether, because under a noncontributory system pensions would be determined by the System and the plan would be administered accordingly. Such a decision would lead to some problems, for at present there was an annuity reserve that included funds to which the contributors had a vested right; one possibility might be the purchase of annuity contracts with the reserves now available.

On the question of an increase in benefits to present retirees, President Wayne said he thought he could speak for the whole Board of Trustees in saying that this was considered the item of highest priority. It would be only equitable to take a look at

10/7/66

-10-

3782

that matter completely independent of other problems, and that should be done promptly. The review also should involve the question whether to build into the Retirement System a plan for revision of benefits incident to increases in the cost of living.

President Wayne inquired whether the foregoing was a fair summarization of the sense of the discussion thus far.

Governor Shepardson commented that he concurred in the need to take care of retired personnel appropriately. At present, the allowances were being paid in part from the annuity portion of the accumulated funds on which there had been earnings in excess of reserve requirements. At least to the extent that those funds were involved, he felt it would be reasonable that the costs of providing any adjustment come out of the excess earnings.

President Wayne replied that this would amount to saying that after objective review it had been determined that equity demanded a certain percentage increase in the retirement allowance. The cost of funding a 4 per cent increase would be about \$3.6 million, which would come out of the retirement reserve account, made up of both pension contributions and annuity contributions. In essence, the increased benefits would merely be funded out of unallocated reserves by transfer to the retirement reserve. The question of what to do with other unallocated reserves might lay on the table pending a study of the Retirement System and a determination of the direction in which to proceed.

10/7/66

-11-

Governor Maisel noted that one of the possibilities that might be considered would be conversion of the Federal Reserve Retirement System to a Civil Service-type retirement system. However, as Mr. Smith had pointed out, there was the feeling of employees that their contributions were earning money and something ought to be done about that. This psychological problem was important, more so than the financial problem.

President Wayne said that was one of the reasons that had prompted the current proposal. However, it might not be a tenable solution because of the quasi-governmental character of the Federal Reserve Banks. One approach would be to recommend to the Executive Committee that the proposal for distribution of excess earnings be laid on the table until a study was made of other matters of high priority, including the question of increased benefits for present retirees, the question of early retirement without full actuarial discount, the implications of a noncontributory plan, the areas of primary concern from the standpoint of the competitiveness of the Federal Reserve Retirement System, and the administrative structure of the Retirement System, including possible conflicts of interest in the handling of investments.

Chairman Martin commented that he thought that was a fair statement.

There followed comments about the possible integration of the Civil Service Retirement System with Social Security, including

10/7/66

-12-

3784

the implications of any such integration from the Federal Reserve standpoint, after which Governor Shepardson expressed the view that in principle it seemed there was much to be said for moving toward a completely noncontributory Bank Plan.

Governor Mitchell suggested that an effort to make the Bank Plan competitive with both the Civil Service Retirement System and community retirement systems would inevitably raise a succession of arguments. He saw no chance of that, at least until the Civil Service Retirement System was integrated with Social Security. Therefore, he felt it was more feasible to think in terms of moving in the direction of conformity with local private retirement plans, recognizing that there could not be complete compatibility.

Governor Mitchell also said he thought there was a tendency to confuse the problems involved in attracting and maintaining Reserve Bank staff with the problems involved in providing equitably for retirees. As to the latter problem, he agreed that appropriate steps should be taken, but a simple statement that it had been determined, after study, that increased benefits, to be paid for partly out of undistributed earnings, were justified might have some advantage over an announced tie-in with the cost of living. He also felt that the Retirement System's vesting privilege had become obsolete.

In general, Governor Mitchell believed that the Federal Reserve, from the standpoint of its own interests, should be offering the best

10/7/66

-13-

3785

possible program of retirement, which might include liberalized vesting privileges and some adjustment of post-retirement benefits. The System, in his opinion, should not be held back by the typical community plan; it should be forging ahead with the most advanced community plan. The main problem he had in mind involved only about 18 per cent of total employees, but that included the top employees, and the offering of a better retirement plan was one way of becoming more competitive for personnel of the desired caliber. He would favor provisions for early retirement, possibly with no actuarial discount, feeling that there were a number of people who would like to retire around age 62 and that they now remained simply because they could not afford to retire. There was much to be said for abandoning the actuarial discount purely from a management standpoint; other ways were available of keeping employees that management desired badly to retain.

Governor Brimmer said he thought President Wayne's summarization described precisely the course that should be followed. He shared the concern that had been expressed with regard to present retirees, and he would favor doing something to rectify that situation as quickly as possible. On the question of early retirement, he would favor as a minimum taking action that would eliminate substantial obstructions to early retirement, and perhaps going even further in order to increase managerial flexibility. In addition, he felt that as part of the proposed study it would be desirable to take a

10/7/66

-14-

3786

look at the present procedure under which a commercial bank was retained as consultant on the investment of retirement funds.

Chairman Martin then turned again to Mr. Smith and asked for any further comments in the light of the foregoing discussion. Mr. Smith replied that the course outlined by President Wayne seemed to him to be the best approach. He was in full agreement with the view that the psychological factor involved in the question of undistributed earnings was greater than the actual financial value. It seemed to him that it would be well to continue to hold in abeyance any action with regard to the current proposal for distribution of excess earnings pending a general review of the Retirement System with the idea of making it more attractive and using the undistributed earnings in some other manner for the benefit of the participants. He concurred in the views expressed with regard to early retirement, feeling that that would be to the benefit of both the Federal Reserve Banks and the employees. Like others who had expressed themselves, he believed that the administrative setup of the Retirement System was very complicated, and administration difficult. A clear-cut noncontributory plan would be more attractive from that standpoint; among other things, it would not be necessary to consider changes in the Retirement System each time there was an adjustment in the Social Security laws. All of this, he pointed out, fitted into the pattern of a program such as President Wayne had outlined.

10/7/66

-15-

Asked by Chairman Martin for further comment regarding the possibility of a noncontributory plan, Mr. Smith reiterated that he was inclined to look with favor on such a proposal. He recognized that there would be some difficulties in arriving at a solution for the disposition of the amounts currently in the retirement fund, part of which represented voluntary contributions. He doubted whether it would be feasible to think in terms of buying annuities with that money. Probably it would be necessary to reimburse the contributors if they so desired, and there might be a liquidation problem if a lot of people wanted their money immediately. There would also be problems with regard to the pension accumulation account toward which the Reserve Banks had contributed. Under current rules, that money had vested with the Retirement System to be used for the benefit of the members, and it could hardly go back to the Reserve Banks. That was in accordance with the Rules and Regulations and the Trust Agreement. If something else was substituted, the money would belong to the participants in the Retirement System. Therefore, that money might have to be distributed to them unless it became the basis for a new fund. The question might then arise whether the employees had the right to say that they wanted the money back or were willing to participate in a new plan. That was essentially a legal problem.

Chairman Martin commented that he thought the money probably would have to be distributed in some way before, or in connection

10/7/66

-16-

with, a move to a noncontributory plan, and Governor Maisel remarked that the current inflow under any other plan should be sufficient to obviate any liquidation problem. On the matter of employees' rights, the question of those presently in service versus those coming into the System currently might pose some problem.

The Chairman then turned to Mr. Moody, who said he felt that today's discussion had been comprehensive. The expressions in favor of liberalized benefits for retirees and provision for early retirement tied in with his own thinking. If those matters could be taken care of soon and the study then go into other problems without undue delay, reasonable solutions should appear. He was in favor of a noncontributory plan.

On the subject of early retirement, Governor Shepardson inquired about the handling of situations in which personnel might not elect that option, even if adjustments were made, although it would be advantageous from the management standpoint.

While it was generally agreed that that problem would obtain in some cases, the view also was expressed that there would no doubt be numerous cases where employees would elect early retirement if full actuarial discount was not a barrier.

Mr. Smith said he was encouraged by the views he had heard expressed regarding the desirability of providing a retirement system sufficiently attractive to encourage persons to enter and remain in the Federal Reserve System, and Chairman Martin commented

10/7/66

-17-

that the procedure outlined by President Wayne was the one that it would seem appropriate to pursue. President Wayne said that an Executive Committee meeting would be called for Monday, October 31.

Governor Shepardson urged moving expeditiously on the question of increased benefits for present retirees, ahead of other parts of the study, and President Wayne agreed with the desirability of prompt action on that particular problem, along with the question of early retirement without full actuarial discount. Those matters could be considered separately from some of the other problems that had been discussed, thus preventing them from becoming imbedded in the longer-run study.

Chairman Martin indicated that the Board agreed with those comments, and President Wayne said that the Retirement Committee would be asked to come in before the end of this year, if possible, with a recommendation for increasing benefits to current retirees, with the hope that that feature might be put into effect in early 1967. In order to obtain action as expeditiously as possible, he would propose separating that matter even from the question of early retirement, although it would be hoped that a recommendation might be forthcoming on the latter question without too much delay. The other areas that had been discussed would no doubt require much deeper study. It would probably be necessary to obtain consultant advice on certain aspects of the question of a noncontributory plan such as the legal status of the present funds. The problem of the

10/7/66

-18-

3790

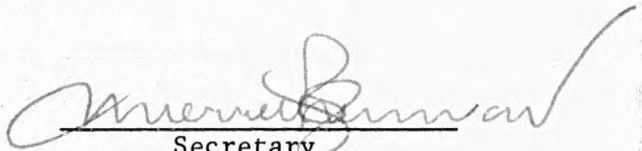
administrative setup with respect to investments seemed to be one more appropriate for review by the Executive Committee and the Board of Trustees than by the Retirement Committee.

Chairman Martin again urged that the whole study be expedited and suggested that the question of a noncontributory plan be presented at the Executive Committee meeting on October 31.

President Swan agreed and noted that the Board of Trustees had in fact recommended in June that that matter be studied. The only thing that had not come up previously in any way was the question of the administrative setup relating to investments, including possible conflicts of interest and possible alternative approaches.

President Swan added the comment that the matter of earlier and more complete vesting was a matter deserving serious consideration, and there was general agreement with that comment.

The meeting then adjourned.


Secretary