FR 609

Minutes for October 25, 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 _____

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, October 25, 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. Kenyon, Assistant Secretary
Mr. Bakke, Assistant Secretary
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Associate General Counsel
Messrs. O'Connell and Shay, Assistant General Counsel
Mr. Smith, Associate Adviser, Division of Research and Statistics
Messrs. Leavitt and Dahl, Assistant Directors, Division of Examinations
Mrs. Semia, Technical Assistant, Office of the Secretary
Miss Hart and Mr. Sanders, Senior Attorneys, and Messrs. Robinson, Shuter, and Smith, Attorneys, Legal Division
Mr. Golden, Senior Economist, Division of Research and Statistics
Mr. Egertson, Supervisory Review Examiner, Messrs. Burton, Goodfellow, and Lyon, Review Examiners, and Miss Greene, Assistant Review Examiner, Division of Examinations

Reports on competitive factors. A report to the Federal Deposit Insurance Corporation on the competitive factors involved in the proposed merger of West Dover Trust Company, Hartly, Delaware, into Farmers Bank of the State of Delaware, Dover, Delaware, was approved unanimously

for transmittal to the Corporation. The conclusion stated that the proposed merger would not have adverse competitive effects.

A change in the proposed conclusion having been agreed upon, unanimous approval was given to the transmittal to the Comptroller of the Currency of a report on the competitive factors involved in the proposed purchase of assets and assumption of liabilities of Wahkiakum County Bank, Cathlamet, Washington, by Seattle-First National Bank, Seattle, Washington. In the form in which approved, the conclusion read as follows:

> A small amount of competition exists between Wahkiakum County Bank, Cathlamet, and Seattle-First National Bank in the area served by the Cathlamet bank.
>
> Seattle-First National Bank now holds approximately 32 per cent of the commercial bank deposits in the State. Consummation of this transaction would increase this already high level of concentration, and in this respect the competitive effect of the proposal is adverse.

Application of Society Corporation. A memorandum from the Division of Examinations dated October 19, 1966, and other pertinent papers had been distributed in connection with the application of Society Corporation, Cleveland, Ohio, for permission to acquire 80 per cent or more of the outstanding voting shares of The First National Bank of Ashland, Ashland, Ohio. The Division's recommendation was favorable, as was that of the Banking Markets Section of the Division of Research and Statistics.

Following comments by Mr. Lyon in supplementation of the material that had been distributed, the application was approved unanimously,

with the understanding that an order and statement reflecting this decision would be drafted for the Board's consideration.

Otto Bremer applications. There had been distributed a memorandum from the Division of Examinations dated October 20, 1966, with other pertinent papers, regarding the applications of Otto Bremer Foundation and its wholly-owned subsidiary, Otto Bremer Company, both of St. Paul, Minnesota, to acquire an additional 50 per cent of the voting shares of The Citizens State Bank, Rugby, North Dakota. The Division recommended approval, as had the Banking Markets Section of the Division of Research and Statistics.

The memorandum brought out that at present Otto Bremer Company held 46 per cent of the Rugby bank's stock and the Foundation an additional 3 per cent; the proposal would bring the Foundation's holdings, direct and indirect, to 99 per cent.

After summary comments by Mr. Lyon, Governor Mitchell observed that among the Otto Bremer subsidiaries there were 11 nonpar banks, including the Rugby bank. He questioned approval of the application in view of the Board's position that nonpar banking was hostile to the public interest.

Discussion of this point raised the question whether, despite the Board's adverse attitude toward nonpar banking, it would be appropriate to use an unrelated statute to further that position. It was recalled that in the early 1920's court tests of efforts by the System

to enforce par clearance had culminated in an opinion by the Supreme Court that a State statute permitting nonpar banking was constitutional and that the Board was not required by law to establish a universal system of par clearance. Congress had not seen fit to outlaw nonpar banking, and a number of States had statutes expressly authorizing it.

Governor Mitchell commented that it appeared to him that an appraisal of management was involved; approval of the present application would in effect say that a management that condoned nonpar banking, a practice considered contrary to the public interest, should nevertheless be permitted to expand its operations.

Governor Mitchell pointed out also a seeming conflict of logic between two statements in the Division of Examinations' memorandum. It was stated therein that the Legal Division, in its review of the applications for legal sufficiency, had found that there existed prima facie evidence of control in the applicants' system, and that, based upon the Division's interpretation of section 3(d) of the Bank Holding Company Act, the Board could approve an application to acquire additional shares of stock in a bank in another State if the applicant holding company already controlled 25 per cent or more of the stock of that bank. In another part of the memorandum it was stated that Otto Bremer Company had expressed the view that because of its present minority position it lacked authority to improve the management of the Rugby bank, and therefore it sought approval to obtain majority control that would allow it to provide qualified management and protect its investment.

Staff responses brought out that the Legal Division's reference to existing control rested on the statutory definition of a bank holding company, which was written in terms of ownership or control of 25 per cent or more of the stock of two or more banks. From the point of view of the 25 per cent cutoff the Rugby bank was already a subsidiary of the Otto Bremer interests, who owned 49 per cent of the bank's shares; further investment in the bank was therefore permissible despite the prohibition in section 3(d) of the Bank Holding Company Act under which "additional" banks could not be acquired in States other than that in which the bank holding company had its headquarters. The expressed desire of the Otto Bremer interests, however, was to achieve actual voting control. They could now be outvoted, theoretically, by individuals who owned 51 per cent of the bank's shares.

In the course of expressions of views by members of the Board, Governor Mitchell commented that although the proposed transaction would serve the corporate interest, to which he usually was willing to give considerable weight, here he saw no particular benefit to the public interest. It appeared to him that there was nothing the Rugby bank could do after the transaction that it could not do at the present time. In addition, the Otto Bremer interests were permitting nonpar banking.

Governor Robertson said he would vote in favor of the application. However, he suggested that the Board's position regarding nonpar banking be brought to the attention of the applicants. The point would

not be made a condition of approval, but there could be a reminder that the Board regarded nonpar banking as adverse to the public interest.

After further discussion the applications were approved, Governor Mitchell dissenting, with the understanding that an order and statement reflecting this decision would be prepared for the Board's consideration along with a dissenting statement.

Messrs. Smith (Associate Adviser), Smith (Legal), Golden, Burton, Egertson, and Lyon, and Miss Greene then withdrew from the meeting.

Denver Branch building (Item No. 1). On October 11, 1966, and at certain subsequent meetings, the Board had discussed a request from the Federal Reserve Bank of Kansas City for authorization to award contracts in connection with a proposed new building for the Denver Branch.

There had now been distributed a memorandum dated October 24, 1966, from Mr. Farrell, noting that Vice President Snider of the Denver Branch of the Reserve Bank had transmitted a copy of the minutes of a meeting held October 20 in Denver between (a) representatives of the Federal Reserve Bank and its Denver Branch, and (b) representatives of the seven general contractors who had submitted bids for construction of the new building. At that meeting (as reported to the Board by Governor Shepardson on October 21) Chairman Scott of the Reserve Bank had presented the question whether the original bidders should be invited to submit new bids on the basis of revised specifications. The minutes of the meeting indicated that it was the unanimous view of the

contractors that the contract should be awarded to the original low bidder on the basis of his bid and subsequent negotiations. The Board had been furnished a copy of the contractors' recommendation for the record, signed by a representative of each of the contractors.

Under these circumstances, Mr. Farrell believed it would be appropriate for the Board to inform the Reserve Bank that it approved:

(1) Acceptance by the Bank of the low base bid submitted by Hensel Phelps Construction Co. of $5,220,000, with the understanding that the bid would be revised to reflect --

(a) Deletion of all Steelcrete and reinforcing steel in the floors, walls, and ceilings of both vaults and replacement with #6 bars to be installed 6 inches on center both ways, top and bottom of the slabs, and in each face of the vault walls;

(b) Provision for a 24-inch ceiling for that part of the depository vault that was under the main basement vault and for a 30-inch ceiling for the remainder of the depository vault;

(c) Elimination of the provision for the Colorado State sales tax.

(2) Awarding the contract to Diebold, Inc., for vault doors and security equipment at a contract price of $401,474.

(3) Providing for a 5 per cent contingency allowance, architects' fees, and other project costs as outlined in Mr. Clay's letter of September 28, 1966.

It was noted that President Clay had sent a telegram in effect confirming the understanding contemplated by the recommended authorization and fixing the total cost of the project at $5,650,396.

In discussion Governor Brimmer stated that although he would approve the recommendation he had reservations as to the Board's procedures with respect to review of construction projects. He suggested that the Board ask its staff to examine the outstanding instructions to the Reserve Banks with a view to assuring compatibility with generally accepted ethical standards. He also suggested that the staff, in making such a review, bear in mind any relevant provisions of the antitrust laws.

Governor Maisel agreed that it would be well to draw up a new outline of procedures, particularly the procedures to be followed in the event a low bid was not accepted outright, either because of changes in specifications or for other reasons.

Governor Mitchell suggested that the restatement of procedures also include material on construction standards. These had varied from one building to another; for example, Steelcrete vault reinforcement was included in some projects but not in others.

At the conclusion of the discussion a telegram to the Federal Reserve Bank of Kansas City in the form attached as Item No. 1 was approved unanimously. It was understood that the staff would explore the several questions that had been raised looking toward redefinition of procedures and standards.

Mr. O'Connell then withdrew from the meeting.

Interpretation of Regulation K (Item No. 2). There had been distributed a memorandum dated October 14, 1966, from the Division of

Examinations regarding the calculation of aggregate liabilities under the Board's Regulation K, Corporations Engaged in Foreign Banking and Financing under the Federal Reserve Act. Section 211.9(c) of the regulation stated in part that "Except with prior Board permission, a Corporation's aggregate outstanding liabilities on account of acceptances, monthly average deposits, borrowings, guarantees, endorsements, debentures, bonds, notes, and other such obligations shall not exceed ten times its capital and surplus; . . ." Question had been raised by an Edge corporation whether, in calculating aggregate liabilities, gross demand deposits should be included in monthly average deposits or demand deposits net of demand balances due from banks and cash items in process of collection. The question had immediate implications for several section 25(a) corporations that operated in New York City as subsidiaries of banks outside New York.

The memorandum explained the method of operation of such corporations, in which transactions were usually settled through officers' checks in clearing house funds, which generated a considerable amount of float and consequent swelling of aggregate liabilities. It was pointed out also that section 25(a) corporations were subject to reserve requirements against deposits in the United States and that Regulation K provided that their deposits for that purpose should be reported in the same manner as if the corporation were a member bank of the Federal Reserve System. Regulation D, Reserves of Member Banks, provides that

in determining their required reserves member banks may deduct from their gross demand deposits the balances subject to immediate withdrawal from U.S. offices of other U.S. banks (other than the Federal Reserve Banks) and cash items in process of collection. For these and other reasons stated in the memorandum, the Division of Examinations recommended that the Board rule that in determining "monthly average deposits" in calculating the limitation on aggregate outstanding liabilities in section 211.9(c) of Regulation K, a corporation could deduct from the amount of its gross demand deposits the amounts permitted in section 204.2(b) of Regulation D. It was further recommended that the ruling be published as a Board interpretation.

After discussion, the proposed interpretation was approved unanimously. A copy of the interpretation as published in the Federal Register is attached as Item No. 2.

Messrs. Shay, Dahl, and Goodfellow then withdrew from the meeting.

State of Texas bonds (Item No. 3). On August 4, 1966, the Board took the position that under section 5136 of the Revised Statutes several issues of bonds referred to as "Colleges of the State of Texas Constitutional Tax Bonds, Series 1966" were ineligible for underwriting by member banks since they were not supported by an unconditional promise by the State of Texas (or by any other governmental entity possessing general powers of taxation) that the interest and principal would be paid when

due. It was understood that the bonds were to be serviced from the proceeds of an ad valorem tax. The Board's long-standing position was that for an obligation to qualify as a "general obligation" it must be supported by a promise that "(1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; said term does not include obligations not so supported that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes."

There had now been distributed a memorandum dated October 21, 1966, from the Legal Division regarding a request from the Dallas law firm of McCall, Parkhurst & Horton, transmitted through the Federal Reserve Bank of Dallas, for permission to discuss with the Board or its legal staff whether the Board should reconsider its position with respect to the eligibility of the Colleges of the State of Texas issues for underwriting by member banks. The law firm had submitted to the Reserve Bank an opinion that "the term 'general obligations' means several types of obligations, and, so far as we can determine, an obligation from an ad valorem tax, though limited as to rate, is always considered to be a general obligation." That opinion clearly conflicted with the second requirement of the Board's interpretation of the meaning of "general obligations" in situations such as the one in question where the pledgor of the ad valorem tax had other tax resources. Because the Board's

position on the matter was clear, the Division recommended responding to the law firm along the lines of an attached draft letter that would express the view that no useful purpose would be served by discussion between the law firm and the Board or its legal staff.

During discussion, Governor Maisel pointed out that he had expressed on previous occasions his reservations as to the Board's position in regard to the underwriting of certain types of securities by member banks. It was noted that the policy question was to be reviewed by the Board in the near future.

The letter was then approved, Governor Maisel abstaining. A copy of the letter is attached as Item No. 3.

Bank advertising for deposits. At the meeting on September 2, 1966, the Board discussed a suggestion by the Securities and Exchange Commission for a public statement directed against misleading advertising practices by banks. An initial draft of such a statement prepared by the Commission had been revised by the staff for the Board's consideration. The Board felt that if such a statement was issued it should be sponsored by the several Federal bank supervisory authorities and also by the Federal Home Loan Bank Board. Accordingly, the draft statement, in a form further revised by the Board, was sent to the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Securities and Exchange Commission, and the Secretary of the Treasury for comment.

There had now been distributed a memorandum dated October 20, 1966, from the Legal Division stating that after receipt of comments two interagency staff meetings had been held for the purpose of developing a statement that would be agreeable to the supervisory agencies and to the Commission. The Comptroller of the Currency had been represented only at the first meeting, after which his office indicated that the Comptroller had such fundamental objections to certain parts of the statement that further participation by his office did not seem worthwhile.

The Securities and Exchange Commission had informed the Board that it favored the adoption and publication by the supervisory agencies of the draft statement resulting from the interagency meetings. With one additional change, of which the other participating agencies had been informed, the draft statement, attached to the memorandum, was now presented to the Board for possible adoption and joint publication by the Board, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. The memorandum noted, however, that the Comptroller's non-participation in the program undoubtedly would diminish its effectiveness. Even with his participation, there was a question whether general compliance could be assured without requiring prior approval of advertising copy, which was not contemplated or recommended.

Mr. Sanders pointed out that a principal difference between the present draft and the one previously considered by the Board was in the

addition of item (7): "No statement should be made which implies that insurance coverage for deposits or accounts by one Federal agency is preferable to or safer than that provided by another Federal agency."

The ensuing discussion centered around the question whether Federal insurance provided for bank deposits was not in fact superior to that provided for share accounts in savings and loan associations, especially from the point of view of the possible delay in receiving share account funds. The staff observed that it was difficult to achieve agreement among several agencies; if the Board was not willing to approve in the statement any item as to which there might be differences of opinion, questions might be reopened as to items (3) and (4), which the Board had already accepted. (Item (3) stated that terms such as "guaranteed" and "bank guaranteed" should not be used in connection with interest or dividends; item (4) stated that the term "bond" should not be used in describing a certificate of deposit.)

The discussion then turned to the question of application to outstanding deposit contracts of changes in maximum rates of interest permissible under Regulation Q, Payment of Interest on Deposits. Mr. Hackley noted that under the present terms of the regulation a change in maximum rate would not apply to outstanding contracts. A proposed amendment that would preclude a bank from undertaking the continuance of a given rate despite changes in the official maximum had been submitted to the Board for consideration at one time, but had not been adopted.

Other questions were raised in regard to the interpretation of item (6): "No statement should be made which implies that more than $15,000 of Federal insurance is provided for each depositor in a bank or each member in a savings and loan association."

Mr. Hexter called attention to the difficulty of making the statement effective without the participation of the Comptroller of the Currency and noted that, since it had been announced that the incumbent Comptroller expected to leave office in the near future, the Board might want to defer consideration of the statement until it could be ascertained whether the incoming Comptroller would be willing to participate in sponsoring the statement.

The following discussion indicated general agreement with the approach suggested by Mr. Hexter. Governor Robertson suggested that in the meantime it would be well for the staff to explore the question of insurance comparability.

Accordingly, further consideration of the statement was deferred, with the understanding that the staff would prepare additional material dealing with several of the questions that had been raised.

Probable violations of Regulations T and U. There had been distributed memoranda dated October 14, 1966, from the Legal Division regarding certification to the Board by the Securities and Exchange Commission of the results of an investigation of transactions involving Karl H. P. Swensson, of Seattle, Washington, and his two brothers. The

investigation had revealed a series of stock collateral loans by 39 banks, many made with the assistance of the New York City brokerage firm of Garvin, Bantel & Co., which apparently had violated the Board's Regulations T and U, relating to credit for securities transactions.

The principal Legal Division memorandum, prepared by Mr. Shuter and Miss Hart, set forth the relevant provisions of Regulations T and U, the circumstances surrounding the series of transactions investigated by the Securities and Exchange Commission, and the questions presented under the Board's regulations. It was concluded that the evidence submitted by the Commission strongly indicated that the Swensson loans were "purpose" loans and that the banks that made them violated Regulation U by extending credit in excess of the maximum loan value of the collateral. The evidence further indicated that in accepting "non-purpose" statements in connection with the loans the banks did not meet the standard of good faith set forth in section 221.3(a) of the regulation and in the Board's published interpretations. As to Garvin, Bantel & Co., it seemed clear that a sufficiently high proportion of the transactions had passed through the firm's hands that it should have been aware that the loans might be purpose loans, and that the borrowers' non-purpose statements should not be accepted at face value. As a result, if the Board agreed with its prior position that section 220.7(a) of Regulation T imposed an obligation on creditors to refrain from arranging loans that a good-faith inquiry would reveal to be in violation of Regulation U,

the conclusion followed that Garvin Bantel & Co. had violated that section by failing to exercise good faith in arranging the loans. In addition, the firm could be held to have violated Regulation U and the underlying statute by aiding and abetting the banks' violations. The fact that 39 banks widely scattered across the country made or purchased loans on a routine basis with no apparent effort to look beneath the surface of the transaction for conformity with the regulation seemed to indicate a need for action on the Board's part.

The memorandum recommended that the Board send a reply to the Securities and Exchange Commission expressing the conclusion that, in the absence of extenuating circumstances that might be revealed by further investigation, the material submitted indicated that Garvin, Bantel & Co. may have violated the margin regulations in connection with the Swensson loans. A draft of letter was attached to the memorandum.

The memorandum outlined several alternative courses of action with respect to the banks involved, commented on each alternative, and recommended the third listed, namely, that under the authority of section 17(b) of the Securities Exchange Act of 1934 and/or section 11(a) of the Federal Reserve Act, the Board conduct special inspections of the banks involved to verify the facts and examine their general procedures for stock collateral loans to determine what further action was called for. Attached was a draft of letter to be sent to the appropriate Federal Reserve Banks requesting an inspection of the banks involved.

No recommendation was made at this time with respect to Board action to be taken if violations of Regulation U were found to exist. It was hoped that a result of the inspections would be improved procedures on the part of the banks involved; however, formal referral to the Securities and Exchange Commission and/or the Department of Justice might become necessary. In addition, information gained as a result of the inspections might help the staff develop proposals for amendments to the regulation or enforcement procedures looking toward more effective operation of Regulation U.

After comments by Mr. Hexter supplementing the distributed material, discussion developed a consensus in favor of the Legal Division's recommendation of the third alternative. There was agreement also with suggestions that the memorandum prepared by Mr. Shuter and Miss Hart be edited as necessary and sent to the Federal Reserve Banks for background information in planning inspections of the banks involved, that the memorandum also be sent to the Securities and Exchange Commission, and that the Reserve Banks invite participation by the Regional Comptroller of the Currency in the case of inspection of a national bank and by the local Supervising Examiner of the Federal Deposit Insurance Corporation in the case of inspection of a nonmember insured bank.

Unanimous approval was then given to the sending of the proposed letter to the Securities and Exchange Commission and to the sending of letters to the Reserve Banks concerned requesting special inspections of the banks involved in the Swensson loans.

All members of the staff then withdrew and the Board went into executive session.

Annex building. The Secretary's Office was advised later by Governor Shepardson that during the executive session the Board gave its approval to the concept of Plan "A" (straight front, without center recess) submitted by the architects yesterday for the exterior design of the proposed annex building to be located across C Street and also indicated approval of plans for an interior tennis court and the study of alternative possibilities for expanding the garage to recover the loss of space involved in placing the tennis court in the interior of the building.

The meeting then adjourned.

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

Letter to the Director of the Bureau of the Budget transmitting certain schedules for calendar years 1965, 1966, and 1967, for use in making a presentation on a memorandum basis of data on the financial operations of the Board of Governors in a separate section of the 1968 Federal budget document.

Letter to the Federal Reserve Bank of New York (copy attached as Item No. 4) approving the appointment of Lyman Brown, III, as examiner.

Governor Shepardson also approved today on behalf of the Board a request from Rosemary A. Darlington, Economist in the Division of International Finance, for permission to prepare an article on the West and East German economies since World War II for the World Book Encyclopedia.

Kenneth A. Kenyon
Assistant Secretary

TELEGRAM
LEASED WIRE SERVICE

Item No. 1
10/25/66

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

October 25, 1966.

Clay - Kansas City

In light of information submitted with Mr. Snider's letter of October 21, 1966, Board of Governors authorizes your Bank to take actions proposed in your telegram of October 24, 1966, with respect to Denver building project.

(Signed) Kenneth A. Kenyon

KENYON

TITLE 12 - BANKS AND BANKING

Item No. 2
10/25/66

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. K]

PART 211--CORPORATIONS ENGAGED IN FOREIGN BANKING AND FINANCING UNDER THE FEDERAL RESERVE ACT

Monthly Average Deposits

§ 211.102 Calculating deposits in determining aggregate liabilities of Edge Corporation.

(a) The question has been raised as to the proper method of calculating deposits in determining aggregate liabilities for the purpose of § 211.9(c), which provides, in part, that "Except with prior Board permission, a Corporation's aggregate outstanding liabilities on account of acceptances, monthly average deposits, borrowings, guarantees, endorsements, debentures, bonds, notes, and other such obligations shall not exceed ten times its capital and surplus".

(b) The Board has concluded that in determining "monthly average deposits" in calculating the limitation on aggregate outstanding liabilities in § 211.9(c), a Corporation may deduct from the amount of its gross demand deposits the amounts permitted in § 204.2(b) of this chapter (Regulation D).

(12 U.S.C. 615. Interprets or applies 12 U.S.C. 615.)

Dated at Washington, D. C., this 25th day of October, 1966.

By order of the Board of Governors.

(SEAL)

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 3
10/25/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 27, 1966

Millard Parkhurst, Esq.,
McCall, Parkhurst & Horton,
1400 Mercantile Bank Building,
Dallas, Texas. 75201

Dear Mr. Parkhurst:

This refers to your letter of September 19, 1966, to Philip E. Coldwell, First Vice President of the Federal Reserve Bank of Dallas, and to your subsequent request to that Bank for permission to discuss with the Board of Governors or its legal staff whether the Board should reconsider its position with respect to the eligibility of "Colleges of the State of Texas Constitutional Tax Bonds" for underwriting by member banks.

Your letter expresses the opinion that "the term 'general obligations' [within the meaning of section 5136 of the United States Revised Statutes (12 U.S.C. 24)] means several types of obligations, and, so far as we can determine, an obligation payable from an ad valorem tax, though limited as to rate, is always considered to be a general obligation." This opinion conflicts with the Board's interpretation of the meaning of "general obligations" in situations such as the one in question, where the pledgor of the ad valorem tax has other tax resources (see 1963 Federal Reserve Bulletin 1237, 12 CFR 208.105).

The Board's position is that a "general obligation" must be supported by a promise that "(1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; said term does not include obligations not so supported that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes" (see 1963 Hearings before the House Committee on Banking and Currency on "Increased Flexibility for Financial Institutions", 88th Congress, 1018; 1965 Annual Report of the Board of Governors 238).

It may be helpful to illustrate the conflict between your opinion and the Board's position. Assume that the only taxing authority of the X municipality is to levy an unlimited ad valorem tax against all real property within its jurisdiction. Obligations issued by the municipality containing its unqualified promise to pay principal and interest when due would qualify as "general obligations". If, however, the municipality had the authority also to levy an ad valorem sales tax and it promised to pay its obligations only out of its sales tax revenues, the obligations would not qualify as "general obligations". In such a case, the municipality would not be pledging its full faith and credit - the obligations would not be supported by the municipality's unqualified promise to pay.

The Board's position on this matter has been developed and adhered to after most careful consideration and reconsideration over many years. In the circumstances, the Board believes that no useful purpose would be served by a discussion such as you suggest but will arrange for a conference between your firm and the Board's legal staff on request.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 4
10/25/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 25, 1966

Mr. Fred W. Piderit, Jr., Vice President,
Federal Reserve Bank of New York,
New York, New York. 10045

Dear Mr. Piderit:

In accordance with the request contained in Mr. Timlen's letter of October 20, 1966, the Board approves the appointment of Lyman Brown, III, at present an assistant examiner, as an examiner for the Federal Reserve Bank of New York. Please advise the salary rate and the effective date of the appointment.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.