FR 609

Minutes for November 21, 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 Monday, November 21, 1966. The Board met in the Board Room at 9:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Young, Senior Adviser to the Board and Director, Division of International Finance
Mr. Holland, Adviser to the Board
Mr. Solomon, Adviser to the Board
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Solomon, Director, Division of Examinations
Miss Eaton, General Assistant, Office of the Secretary
Mr. Morgan, Staff Assistant, Board Members' Offices

Messrs. Brill, Koch, Partee, Williams, Smith, Altmann, Eckert, Ettin, Fisher, Gehman, Keir, Rosenblatt, Thompson, Trueblood, and Wernick of the Division of Research and Statistics

Messrs. Hersey, Irvine, Katz, Reynolds, Bryant, Dunn, Emery, Gekker, Gemmill, Klein, and Mills of the Division of International Finance

Economic review. The staff presented a review of domestic and international economic and financial developments of the type customarily given in advance of a meeting of the Federal Open Market Committee.

The staff comments were based to some extent on materials distributed in preparation for the Committee meeting, and copies of the relevant documents have been placed in the Committee's files.

Members of the staff who had been present other than Messrs. Sherman and Kenyon then withdrew and Messrs. Wayne and Swan, Presidents of the Federal Reserve Banks of Richmond and San Francisco, respectively, entered the room. Messrs. Hackley, General Counsel, and Johnson, Director, Division of Personnel Administration, also entered at this point.

Retirement System. Mr. Swan was present in his capacity as Chairman of the Board of Trustees of the Retirement System of the Federal Reserve Banks and Mr. Wayne in his capacity as Chairman of the Executive Committee.

Chairman Martin stated that the purpose of this meeting was to consider certain questions of policy relative to the Retirement System. He then turned to President Wayne, who summarized the several issues that had been discussed at the meeting of the Board and an Ad Hoc Committee of Retirement System Trustees on October 7, 1966, as recorded in the minutes of that meeting.

President Wayne said that the Executive Committee had subsequently met and put in motion studies of two questions: adjusting allowances of present retirees and permitting earlier retirement without full actuarial discount. As to the remaining points discussed at the October 7 meeting, the Executive Committee was concerned about a possible lack of

objectivity in an internal study, and question was raised whether it would not be preferable to arrange for a study by a group of outside consultants. That approach was favored by the Executive Committee, and he (President Wayne), President Swan, and Governor Maisel were designated as a Special Committee to formulate clearly the matters that might be referred to outside consultants for study. In turn, he (President Wayne) had been assigned the task of setting down the salient features of the Retirement System and the questions currently raised concerning it. President Wayne then caused to be distributed a statement that he had prepared under the title "Salient Features of the Retirement System of the Federal Reserve Banks," together with a list of questions concerning the benefits, structure, and policies of the Retirement System. (Copies of the distributed materials have been placed in the Board's files.)

President Wayne proceeded to review the salient features of the Retirement System as he had outlined them and then turned to the questions that reflected his understanding of the principal issues requiring exploration. In terms of benefits, a key question appeared to involve determination of the "market" or "markets" against which benefits provided for the top quartile of Reserve Bank employees should be evaluated; and, on the basis of whatever "market" or "markets" were selected, how far the Reserve Banks could appropriately go in meeting the competition, considering their quasi-public character. In terms of structure, a key

question was whether the decision-making power should remain in the hands of persons who, as potential retirees, might find a conflict between official and personal interests; and if such conflicts, potential or actual, required a complete change in structure, what alternatives were available. In terms of structure and policy, the question was whether a continuation of the investment counseling relationship with Northern Trust Company of Chicago was tenable; and, if not, what alternatives were feasible. In terms of policy, the question was whether the investment policy of the Retirement System was compatible with the public responsibilities and essential public image of the Federal Reserve System; and, if not, whether potential conflicts could be reconciled by a change of policy. Would limitation of all investments to longest-term U.S. Government obligations offer a possible solution? Would it help to eliminate the annuity provisions of the Retirement System and make it a completely noncontributory system?

After reviewing the foregoing questions, President Wayne said he was aware that the Board had leaned over backward to avoid telling the Trustees what they must do and, instead, had tried to maintain a posture of exercising only the ultimate power arising out of the Board's statutory responsibility for the expenditures of the Federal Reserve Banks. He was not certain whether the questions he had written down were those of most concern to the Board of Governors, and it seemed desirable to ascertain whether they were in fact basic questions before

going further. For example, if the present investment program, which involved investment of about 40 per cent of total portfolio in common stocks, was thought to jeopardize the public image of the Federal Reserve System, perhaps that question should be resolved inside the System rather than to seek the advice of outside consultants.

Chairman Martin indicated that the extent of investment in common stocks had been a matter of continuing concern to him. He had some question whether the Retirement System should be dealing in equities at all, and that practice had also been the subject of criticism by some parties outside the System. He suggested that the best course might be to turn to a noncontributory plan and determine the benefits that the Federal Reserve System should provide on a straight-line basis, thereby avoiding the investment problem.

President Wayne noted that one alternative might be to invest only in longest-term Government obligations.

Question was raised about the magnitude of problems involved in transition to a noncontributory plan, and Governor Maisel expressed the view that no great legal problem should be involved although there might be some questions of moral obligation. He suggested that one possibility might be to buy up the rights of those who had contributed.

President Wayne then reviewed the size and purpose of the annuity accumulation, retirement reserve, and pension accumulation accounts, and described the rights of the parties concerned in those accounts.

In further discussion, Governor Mitchell suggested the possibility of retaining an outside company or companies for the purpose of handling the funds and making investment decisions. Governor Maisel observed that if the problem involved was thought to warrant such a procedure it could be resolved by investing only in U.S. Government obligations, but Governor Mitchell raised the question whether that would permit the Federal Reserve to be sufficiently competitive in its retirement program. He noted that the current trend was toward a certain amount of equity participation. Governor Maisel then suggested that another alternative would be to turn the annuity accumulation account over to an insurance company.

President Wayne pointed out that if a study of benefits available in competitive markets was made by consultants, and if the conclusion was reached through such a study that certain benefits were essential from the standpoint of staffing the System adequately, the means of achieving that end could then be examined internally.

Governor Mitchell expressed the opinion that some change in investment structure and policy was called for, and President Wayne then inquired whether he was correct in assuming that that was a problem that had been disturbing the Board. The Presidents, he noted, had not shared that feeling.

Governor Robertson said that the problem had been disturbing to him, after which Governor Mitchell indicated that he was more concerned about the fact that the decision-making power resided in a group

of trustees who, as potential retirees, had a personal interest in the decisions, particularly since the part of the Retirement System study that was on a contributory basis now involved less than 25 per cent of the total number of Reserve Bank employees.

President Swan suggested that the conflict-of-interest problem perhaps was not as serious as it might seem, for the Board of Governors had to approve any proposed changes in Retirement System benefits.

Governor Brimmer said he shared that view. He was not so concerned about possible conflicts of interest within the System as he was about the possible conflicts inherent in the investment structure and policy. He saw a danger that the official positions of the members of the Investment Committee made the System vulnerable to a charge of inadvertent "leaks" of policy decisions of extreme importance to securities markets in the course of consultations with Northern Trust Company.

President Wayne then suggested two possible courses. One would be for the Investment Committee to act directly on its own volition; another would be for the Retirement System to employ full-time personnel who would not have access to the array of information available to the members of the Investment Committee as presently constituted. In any event, however, the structural question might be resolved if the investment policy question was resolved; the two were tied together.

Governor Maisel said that if it should be decided that a contributory plan was needed, with the potential equity gains involved in

it, he could go along with such a decision. However, he would want to look carefully at the structure according to which such a decision was to be implemented. For example, he might want to separate the funds that belonged to the Reserve Banks from the funds that belonged to the participants in the Retirement System and turn the latter funds over to an independent trustee. In other words, he would want to judge what was the best administrative procedure for implementing a decision to maintain a contributory plan.

President Wayne inquired whether that was a Board consensus, and Chairman Martin replied that he would want to go further. In his view it would not be commensurate with the dignity of the System to enter into contractual relationships with outside parties for the management of Retirement System funds. Further, there would be the question of deciding the identity of those parties.

Governor Maisel commented that his suggested plan would simply amount to saying to contributors to the Retirement System that their contributions were going to be placed for investment with an insurance company or some other outside organization and that their funds would simply be collected through the Retirement System. When an employee retired, the outside organization would determine how much he was going to receive. The rest of the Retirement System would be run in the same manner as a Treasury trust fund.

President Wayne commented that there was one aspect of the present program that seemed certain to become increasingly a source of

discontent on the part of employees. By this he referred to the 80 per cent limitation on retirement allowance, which included any portion of such income derived from funds provided by the employee. In this connection he read excerpts from a letter that he had received from Mr. Smith, Trustee representing the New York Reserve Bank and a member of the Ad Hoc Committee of Trustees that had recently met with the Board. Mr. Smith expressed the view that there would be a good deal of discontent among the New York Bank's employees with regard to any limitation imposed on the maximum retirement allowance, if the limitation included income from funds provided by the employees. Mr. Smith considered it highly desirable to move to a noncontributory plan.

Governor Daane inquired whether that might not lessen the attractiveness of Reserve Bank employment in a competitive market, and President Swan expressed doubt that it would. At present only a relatively small proportion of total Reserve Bank staff was on a contributory basis. Their contributions could not be used in the same manner as contributions made by the employees of many private organizations. He did not see that it made much difference whether a person had to make such contributions to the Retirement System or whether the equivalent funds were left for the employee himself to invest. Governor Daane replied that he would want to have a study of the competitive impact made before reaching a decision.

President Wayne then said he judged from today's discussion that the Executive Committee should ask a group of consultants to provide

factual information on the trends in the markets in which the Federal Reserve was considered to be competing and what benefits under the Federal Reserve Retirement System appeared to be required in order to provide a progressive system that would be sufficiently competitive to attract and retain competent staff. However, the consultants should not be asked for a recommendation on the means by which such a system should be achieved.

Governor Daane agreed, saying that he thought it should be determined internally how to obtain the desired result administratively while maintaining the System's public image.

Governor Robertson concurred in the view that the best advice available should be obtained to determine the benefits that must be provided to attract and retain competent staff. Once the appropriate range of benefits was determined, it would be advisable to keep abreast of developments on a regular basis through outside advisers. In his judgment the Retirement System's funds should be invested only in long-term U.S. Government bonds, and any deficiency should be made up by the Federal Reserve System.

President Swan noted that a decision to limit investments to Government bonds would appear to mean that a contributory Reserve System plan could not be made as good as those offered by market competitors.

Governor Brimmer commented that a key question involved was the basic attitude taken toward investment in common stocks. If the

decision was against such investments, then one must come out at about the same place as Governor Robertson. Governor Brimmer added that he, too, was concerned about investments in common stocks.

Governor Maisel returned to a discussion of the alternative procedure he had mentioned previously. If the decision should be to maintain a contributory plan, there would be the possibility of entering into some form of contract with an outside company so that the System would have nothing to do with the funds contributed by the employees. In effect, there would be a contract between the contributor and the outside company.

Governor Daane expressed sympathy with such an approach, adding that much would depend on who did the investing and whose funds they were investing.

Chairman Martin commented that he would not like to see the Federal Reserve System in the position of determining what company the employees would have to use.

Governor Shepardson said it was his impression that the current trend was away from contributory plans, and President Wayne replied that something depended on the market or markets with which the Federal Reserve concluded that it was principally competing.

Governor Mitchell expressed the view that if the Federal Reserve Retirement System was to be competitive with the best private systems, it would be necessary to include some inflationary hedge. Governor

Robertson pointed out that the Civil Service Retirement System provided for cost-of-living adjustments, and Governor Maisel mentioned that computation of the retirement allowance on the basis of the highest five-year average salary (normally the last five years of service) represented something of an inflationary hedge.

Governor Shepardson said he was in favor of flexible adjustment. He noted that the Civil Service plan was contributory, but that it contained no provision for equity gain.

President Wayne commented that in private industry the problem was taken care of to a certain extent through stock purchase arrangements and the like. Financial institutions had been moving toward totally noncontributory systems, adjusted rather frequently. In the academic world an employee frequently could choose how much he wished to contribute to provide equity growth, while the Civil Service plan included provision for cost-of-living adjustments.

President Wayne repeated that it seemed to him the first problem was to determine with whom the Reserve Banks were primarily competing. The next question would be whether and how the Reserve Banks could meet the competition. He inquired as to the degree of urgency seen by the Board in amending the investment program.

Governor Robertson expressed the view that it was an urgent matter, while Governor Brimmer indicated that he would want to await further study. However, on the question of adjustment of retirement allowances for present retirees, he would not want to wait.

President Wayne then described the steps that had been put in motion, on the question of present retirees' allowances, that should permit a proposal to be submitted to the Board around the first of the year. He also described the work that was being done on the question of permitting earlier retirement without full actuarial discount, with the thought of placing a proposal before the Board for consideration at a relatively early date. However, the other Retirement System problems that had been discussed would be held in abeyance until a study was made by consultants to determine what was going on in competitive markets. It was his opinion that this broader study might require a year. He inquired whether there was any reason, in the Board's judgment, for the Executive Committee to go outside the Federal Reserve System for guidance in choosing the consultants who would make that kind of study.

Response was made that the Board saw no reason to take that step in choosing the consultants and that the objective should be simply to obtain the best advice available.

President Wayne concluded the discussion by saying that he understood that minds would not be closed on the kind of retirement system that should be provided until a study of the practices of competing organizations was available.

Presidents Swan and Wayne then withdrew, along with Mr. Johnson, and the following entered:

Messrs. O'Connell and Robinson of the Legal Division
Messrs. Solomon, Leavitt, Lyon, and Rumbarger of the Division of Examinations
Messrs. Smith and Golden of the Division of Research and Statistics

Application of Baystate Corporation. There had been distributed a memorandum from the Division of Examinations dated November 7, 1966, and other relevant material regarding an application by Baystate Corporation, Boston, Massachusetts, for prior approval of the acquisition of up to 100 per cent of the outstanding voting shares of The Merchants National Bank of New Bedford, New Bedford, Massachusetts. The Division concluded that there would be no significant anticompetitive effects, that the small increase in concentration resulting from the proposed acquisition should not be considered a bar to approval, that the banking factors were consistent with approval, and that the convenience and needs factor lent some support. The Banking Markets Section concurred in the favorable recommendation.

Mr. Lyon reviewed the principal factors involved and noted that final action by the Massachusetts Board of Bank Incorporation was still pending.

Governor Shepardson said he could not find a great deal for or against the application. In general, where there were no significant reasons against approval, he tended to favor permitting the transaction. To a certain extent the proposed acquisition would facilitate a solution to a developing management succession problem at the New Bedford bank. Admittedly, there did not appear to be any immediate problem in that regard, and there should be other solutions in the case of a $40 million bank. On balance, however, he would go along with the favorable staff recommendation.

Governor Mitchell agreed generally with the comments made by Governor Shepardson. He could not see that the public interest would be injured, and consummation of the proposed acquisition would be in the corporate interest.

Governor Daane indicated that he would approve for the reasons given by the Division of Examinations.

Governor Maisel pointed out that the top five commercial banking organizations in the State of Massachusetts, including the two registered bank holding companies, presently controlled 64 per cent of the total deposits of commercial banks in the State. He felt that the Board had not developed a basic philosophy as to the point at which additional concentration became critical, and precedents were being established by actions on individual applications on an ad hoc basis. He hoped that some general philosophy could be developed. However, he would approve this particular application.

Governor Brimmer said he had reservations about the apparent willingness of the staff to assign such a high degree of importance to the management factor at the New Bedford bank. He was convinced that there were alternatives to the proposed acquisition that would resolve whatever problem might exist in that regard. On balance, though, he would support the recommendation of the Division of Examinations.

Governor Robertson commented that as a general rule he felt the Board should not act on applications of this kind until final action

had been taken by the State authorities. As to the merits of the present application, he was unable to find evidence that the public interest would be benefited. The New Bedford bank, with total deposits of over $40 million, was in sound condition. The application contemplated its being acquired by a bank holding company that already controlled 10 per cent of the total deposits of commercial banks in the State and 18 per cent of the total banking offices. The factor of banking concentration in Massachusetts was becoming more and more acute, with the top five commercial banking organizations controlling a substantial majority of total commercial bank deposits, and he felt that it was undesirable to add further to such a degree of concentration.

Chairman Martin said that he would approve the application. He added, however, that he agreed with Governor Robertson that generally speaking it was advisable for the Board to defer consideration of applications until after the State authorities had acted.

The Baystate application was thereupon approved, Governor Robertson dissenting, with the understanding that an order and statement reflecting the decision would be prepared for the Board's consideration, along with a dissenting statement, but that the Board's order would not be issued until after advice had been received of favorable action by the Massachusetts State authorities.

Technical assistance request. Governor Robertson reported that officials of the Department of the Army had advised him that the Department would like to have a current appraisal made of the economy of the

Ryukyu Islands. Such a review was desired within the near future, and on a basis that should not require a period of more than 10 days or two weeks. Governor Robertson suggested that Mr. Irvine and one of the other economists in the Division of International Finance be made available for the assignment, and there was general agreement that the providing of staff services along such lines would be appropriate.

Secretary's Note: Messrs. Irvine and Emery subsequently undertook the assignment, with reimbursement to the Board by the Department of the Army for travel and per diem.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board memoranda recommending the following actions relating to the Board's staff:

Appointment

Albert Long as Messenger, Division of Administrative Services, with basic annual salary at the rate of $3,609, effective the date of entrance upon duty.

Transfer

Frances B. Loveless, Clerk-Typist, Division of Personnel Administration, to a new budget position in that Division, effective December 4, 1966, with no change in basic annual salary at the rate of $3,925.

Acceptance of resignation

James H. Lowden, Messenger, Board Members' Offices, effective November 27, 1966.

Secretary