FR 609

Minutes for December 19, 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, December 19, 1966. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. O'Connell, Assistant General Counsel
Mr. Partee, Associate Director, Division of Research and Statistics
Mr. Kiley, Assistant Director, Division of Bank Operations
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Smith, Assistant Director, Division of Examinations
Miss Wolcott, Technical Assistant, Office of the Secretary
Mr. Forrestal, Senior Attorney, Legal Division
Mr. Ring, Technical Assistant, Division of Bank Operations
Mr. Egertson, Supervisory Review Examiner, Division of Examinations

Approved items. The following items were approved unanimously after consideration of background information that had been made available to the Board. Copies are attached under the respective numbers indicated.

	Item No.
Letter to Wachovia Bank and Trust Company, Winston-Salem, North Carolina, approving the establishment of a branch in or adjacent to the Arrowood-Southern Industrial Park, Mecklenburg County.	1
Letter to Arkansas Bank and Trust Company, Hot Springs, Arkansas, approving the establishment of a branch at 200 Park Avenue.	2
Letter to United California Bank, Los Angeles, California, approving the establishment of a branch in Livermore.	3
Letter to the Bureau of the Budget regarding a draft bill prepared by the Office of Emergency Planning "to amend the Defense Production Act of 1950, as amended, and for other purposes."	4

In connection with Item No. 3, it was noted that an examination of United California Bank had been begun on December 5, 1966. The consensus was not to mention the bank's capital position in the letter approving the branch but to review the situation carefully after the conclusion of the current examination.

With respect to Item No. 4, the Division of Research and Statistics had indicated that the draft legislation, if enacted, would have no adverse effects from the standpoint of monetary policy. The proposed bill would increase from $2.1 billion to $2.8 billion the borrowing authority of the Revolving Fund established under section 304(b) of the Defense Production Act for purposes of providing Government encouragement to certain types of industrial expansion related to the national defense. It would also eliminate the restriction of $100 million in the

Act for new contracting, thus permitting the evaluation of all expansion proposals on the basis of probable ultimate net cost, as originally stipulated in the Act. Further, it would extend the expiration of the authorities contained in the Act to June 30, 1969.

"Guaranty fund" in Bank of the Commonwealth. There had been distributed a memorandum dated December 15, 1966, from the Legal Division relating to a question raised by the Federal Reserve Bank of Chicago as to whether a $10 million "guaranty fund" maintained by the Federal Deposit Insurance Corporation in Bank of the Commonwealth, Detroit, Michigan, was a deposit liability for purposes of the reserve requirements of Regulation D, Reserves of Member Banks.

The guaranty fund came into existence in connection with the purchase of assets and assumption of liabilities of Public Bank, Detroit, Michigan, by Bank of the Commonwealth from the Federal Deposit Insurance Corporation, as receiver, at a gross purchase price arrived at in accordance with certain specified guidelines. Under the terms of the agreement dated September 19, 1966, it was understood that a net purchase price would be determined on a settlement date 18 months from the execution of the agreement. In order to afford Bank of the Commonwealth some protection against potential losses on the assets of Public Bank, the Federal Deposit Insurance Corporation agreed to place with Commonwealth a so-called guaranty fund of $10 million. The full amount of the fund could be intermingled with the assets of Commonwealth without obligation on

its part to pay interest to the Corporation. In addition, Commonwealth reserved the right to require the Federal Deposit Insurance Corporation to withdraw all or part of the fund at any time, in which event the withdrawn funds would bear interest at the rate of 5 per cent. After the settlement date, in accordance with a schedule in the agreement, a certain percentage of the fund would be maintained, which would also bear interest at 5 per cent annually.

In view of the unique nature of the fund, which was not established within the ordinary business of a commercial bank but for the specific purpose of facilitating the purchase of assets and assumption of liabilities of Public Bank by Bank of the Commonwealth, the Legal Division concluded that prior to settlement date the guaranty fund was not a deposit liability against which reserves must be carried. After settlement date, however, the principal reason for which the fund was established would cease to exist. For reasons set forth in the distributed memorandum, the Legal Division concluded that any remaining portion of the fund would then be held by Commonwealth in the course of its commercial business and should be classified as a demand deposit against which reserves should be carried. Attached to the memorandum was a draft of letter to the Federal Reserve Bank of Chicago that would set forth these conclusions.

After summary comments by Mr. Forrestal based largely on the distributed material, and supplementary remarks by Messrs. Hackley and

O'Connell, discussion developed a general view on the part of the Board members that the circumstances were such that the guaranty fund should not be regarded as a deposit, at least prior to settlement date. Mr. Hackley observed that it was his understanding that the Federal Deposit Insurance Corporation did not expect the guaranty fund to be so regarded for insurance assessment purposes. Question was then raised whether the guaranty fund should not in fact be construed as a loan. Such a disposition of the matter would eliminate interpretation problems under Regulations D and Q (Payment of Interest on Deposits), including the question of deposit classification for such purposes after settlement date.

Following further discussion, it was agreed that the Legal Division would determine whether the classification of the fund as a loan would present any difficulty from the standpoint of the Federal Deposit Insurance Corporation.

In view of certain questions that had come up during the foregoing discussion relating to the extent of the Board's awareness of the negotiations that resulted in the creation of the guaranty fund, it was agreed, at the suggestion of Governor Brimmer, that the staff would endeavor to construct a complete record, for future availability as needed, covering the System's knowledge of and participation in the various steps that were taken at the bank supervisory level in connection with the Public Bank matter.

Local destruction of Federal Reserve notes (Items 5 and 6). On December 12, 1966, the Conference of Presidents approved the recommendations

of its Subcommittee on Currency and Coin that redemption credit for unfit $5 and $10 Federal Reserve notes destroyed without sort by Bank of issue be allocated in proportion to the previous year's issues, but that $20 and higher denomination notes continue to be sorted pending further study. The Conference suggested that January 1, 1967, be set as the effective date for discontinuing the sort by Bank of issue on $5 and $10 notes.

There had now been distributed a memorandum dated December 14, 1966, from the Division of Bank Operations recommending that the Board adopt the formula approved by the Presidents' Conference, which formula was the same as that now used in allocating redemption credit for $1 Federal Reserve notes. Attached to the memorandum was a draft of letter to the Presidents of all Federal Reserve Banks that would inform the Banks that the sorting of $5 and $10 notes should be discontinued at the end of December and transmit procedures for apportioning credit among Federal Reserve Banks for unfit Federal Reserve notes destroyed without sort by Bank of issue.

After discussion based on the distributed material and supplementary remarks by Mr. Farrell, the letter to the Federal Reserve Banks was approved unanimously. A copy is attached as Item No. 5.

On November 18, 1966, the Board agreed to a proposal of the Treasury Department that local verification and destruction of unfit $5 and $10 Federal Reserve notes be started on December 1, 1966, using

a percentage verification at or near the limits imposed by the regulations of the Secretary of the Treasury, namely, not less than 10 per cent of the $5 denomination and not less than 20 per cent of the $10 denomination.

At that meeting Mr. Smith noted concern on the part of the General Auditors of the Federal Reserve Banks that the suggested sampling procedures for verification of cancelled currency in lieu of the complete verification previously followed would open up possibilities for fraudulent acts by Reserve Bank personnel unless operating procedures were so drawn as to provide strengthening controls and safeguards. The auditors did not feel that compliance with minimum procedures required in the Treasury Department's covering regulation would be sufficient.

There had now been distributed a memorandum dated December 14, 1966, from the Divisions of Examinations and Bank Operations recommending that a letter be sent to the Reserve Banks endorsing the principle of verification by sampling procedures but emphasizing the importance of adherence to sound procedures in carrying out the System's responsibilities. Attached to the memorandum was a proposed letter along the lines suggested.

In commenting on the situation, Mr. Smith expressed the view of the auditors that a tendency might develop on the part of Reserve Banks to drift toward compliance with no more than the minimum procedures

required in the Treasury's covering regulation because of the cost factor. He felt an appropriate balance should be struck between cost and security. A letter along the lines suggested would at least mark the area as one deserving careful consideration.

The ensuing discussion turned mainly on the question whether the letter to the Reserve Banks should merely call attention to the Board's concern that sound procedures be followed or whether it should endeavor to provide more specific guidance to the Banks in determining appropriate standards. One view expressed was that the individual Banks might appreciate having the benefit of guidance from a central source to help them in coordinating with what other Banks were doing. It was noted, however, that on most operational matters the Board had typically relied on the management of the individual Reserve Banks for the maintenance of adequate standards, particularly since conditions might vary to a certain degree from one Bank to another. It was noted that inter-Bank communication was provided through the periodic conferences of the General Auditors, and that the Board's examiners were charged with reviewing operations at the individual Reserve Banks from a security standpoint, thus tending to minimize deviations from normal standards. It was agreed that the question of appropriate standards in the area under discussion should have consideration at the next General Auditors' conference.

A suggestion for a change in the third paragraph of the proposed letter was then agreed upon in light of the foregoing discussion, following

which unanimous approval was given to a letter to the Federal Reserve Banks in the form attached as Item No. 6.

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

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

Transfer

Nathan L. Hunter, from the position of Messenger to the position of Messenger-Driver, Division of Administrative Services, with no change in basic annual salary at the rate of $3,609, effective December 19, 1966.

Secretary

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

Item No. 1
12/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 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 in or adjacent to the Arrowood-Southern Industrial Park, Mecklenburg County, North Carolina, provided the branch is established within six months from the date of this letter.

Very truly yours,

Elizabeth L. Carmichael,

Elizabeth L. Carmichael,
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
12/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 1966

Board of Directors,
Arkansas Bank and Trust Company,
Hot Springs, Arkansas.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by Arkansas Bank and Trust Company, Hot Springs, Arkansas, of a branch (teller's window) at 200 Park Avenue, Hot Springs, Arkansas, provided the branch is established within one year from the date of this letter.

Very truly yours,

Elizabeth L. Carmichael

Elizabeth L. Carmichael,
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. 3
12/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 1966.

Board of Directors,
United California Bank,
Los Angeles, California.

Gentlemen:

The Board of Governors of the Federal Reserve System approves the establishment by United California Bank, Los Angeles, California, of a branch in the vicinity of the intersection of First and O Streets in Livermore, Alameda County, California, provided the branch is established within one year from the date of this letter.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
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. 4
12/19/66

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 1966.

Mr. Wilfred Rommel,
Assistant Director for
Legislative Reference,
Bureau of the Budget,
Washington, D. C. 20503

Dear Mr. Rommel:

This is in response to your Legislative Referral Memorandum of December 9, 1966, requesting the Board's views on a draft bill "To amend the Defense Production Act of 1950, as amended, and for other purposes", prepared by the Office of Emergency Planning.

The Board has no objection to the proposed legislation.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 5
12/19/66

S-2010

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 1966.

Dear Sir:

The Board has adopted the formula approved by the Conference of Presidents on December 12, 1966, for allocating redemption credit for unfit $5 and $10 Federal Reserve notes destroyed without sort by Bank of issue. As recommended by the Presidents, the sorting of $5 and $10 notes should be discontinued at the end of December.

Enclosed is a statement of "Procedures for Apportioning Credit Among Federal Reserve Banks for Unfit Federal Reserve Notes Destroyed Without Sort by Bank of Issue." These procedures provide for a weekly and month-end settlement through the Interdistrict Settlement Fund of all unfit $1, $5, and $10 Federal Reserve Notes turned over to the currency verification and destruction units during the preceding period.

Credit for the notes cleared through the settlement will be allocated on the basis of net issues of notes by the Federal Reserve Agents during the preceding calendar year. Percentages for such allocations will be computed each January for use during the twelve months beginning with the first settlement in February. You will be notified of the percentages upon their establishment.

This letter supersedes the Board's letter of May 6, 1966 (F.R.L.S. #5800;S-1991) and supplements outstanding instructions for handling unfit Federal Reserve notes (F.R.L.S. #5800) to the extent that notes are destroyed locally without sort by Bank of issue.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

PROCEDURES FOR APPORTIONING CREDIT AMONG THE FEDERAL RESERVE BANKS FOR UNFIT FEDERAL RESERVE NOTES DESTROYED WITHOUT SORT BY BANK OF ISSUE

1. Federal Reserve Banks and branches destroying unfit Federal Reserve notes will maintain two additional accounts, as follows:

(1) For Federal Reserve notes of own Bank[1/] delivered to currency verification and destruction unit, but not yet cleared through settlement.

(2) For Federal Reserve notes of other Federal Reserve Banks delivered to currency verification and destruction unit, but not yet cleared through settlement.

2. The accounts will be charged with a pro rata portion of the amount of cancelled Federal Reserve notes delivered to the currency verification and destruction unit. The amounts allocated to the two accounts will be determined by each office on the basis of a periodic sampling or test check of the notes of own Bank and of other Banks received from circulation.

3. The amount in the first account will be reported on form FR 34 in the item "Federal Reserve notes: Forwarded for redemption," and that in the second account will be reported in the item "F.R. notes of other F.R. Banks."

4. The total of the two accounts at the close of business each Tuesday and the next to the last business day each month, combined for the district, will be wired to reach the Board (Division of Bank Operations) by 1:30 p.m. each Wednesday and the last business day of the month under code CYROR, the definition of which is:

"Unfit Federal Reserve notes were turned over to currency verification and destruction unit (units) of this Bank for destruction and credit during period ending ____(date)____ in total amount of $____(A)_____ Ones; $____(B)_____ Fives; $____(C)_____ Tens; $____(D)_____ Total.

In the case of a holiday observed by all the Banks and the Board, the dispatch of wires and the note clearing will take place one day earlier. In the case of holidays observed by one or more Banks or the Board advance notice will be given with regard to the clearing.

5. The Board's Division of Bank Operations will calculate each Bank's portion of the notes turned over to currency verification

1/ Branches may wish to designate the account as Federal Reserve notes of parent Bank, in order to conform with form FR 34.

and destruction units by all Reserve Banks and the Treasury's Cash Division during the period.

6. Settlement will be made by direct entries to the Interdistrict Settlement Fund. If a Bank's portion of the combined total of notes delivered for destruction and credit exceeds the amount it delivered for destruction and credit during the period, its participation in the Fund will be decreased by such excess. If a Bank's portion of the combined total of notes delivered for destruction and credit is less than the amount it delivered for destruction and credit during the period, its participation in the Fund will be increased by such difference.

7. The Division of Bank Operations will dispatch a book message to all Banks and Assistant Federal Reserve Agents at about 3:00 p.m. on the settlement day under code CYRUS, the definition of which is:

> "Your Bank's portions all unfit Federal Reserve notes delivered to currency verification and destruction units in period ending ___(date)___ are $___(A)___ Total; $___(B)___ Ones; $___(C)___ Fives; $___(D)___ Tens. Federal Reserve Agent is requested to make settlement direct with your Bank for the amount. We debit (-) or credit your account Interdistrict Settlement Fund today $___(E)___ to adjust for the sum of the differences between amounts your Bank delivered for destruction and credit and your Bank's portions of total amounts delivered for destruction and credit at all Reserve Banks during period."

8. Upon receipt of Board's wire each Bank will make an entry closing out the previous day's balances in the two currency verification and destruction unit accounts, with the offsetting entries being reflected in the Federal Reserve Notes Outstanding and the Interdistrict Settlement Fund accounts in accordance with items B-D and E, respectively, in the settlement wire.

9. Branches destroying unfit Federal Reserve notes will settle with their head offices.

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

Item No. 6
12/19/66

S-2011

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 19, 1966.

Dear Sir:

This refers to Treasury Department regulations governing the redemption, verification, and destruction of unfit United States paper currency and Federal Reserve notes as revised effective December 1, 1966.

In authorizing the destruction by the Reserve Banks of Federal Reserve notes of $5 and $10 denominations the Treasury regulations provide that the verification include a minimum piece-count of specified percentages and it is noted that this piece-count requirement is the same for each type of currency (U.S. and Federal Reserve) whether the verification is performed at the Reserve Banks or the Treasury Department. The experience of the Treasury Department over the years seems to warrant this procedure of verification of canceled currency on a sampling basis in amounts at or near but not less than the minimum percentages suggested by the Treasury Department, and the Board suggests that any higher percentage count by the Currency Verification Units be made only in special circumstances rather than as a daily operating routine.

However, since the main purposes of the test verification are to obtain satisfactory assurance that the currency to be destroyed actually is in the amounts represented and that the work of the currency sorters attains the established standards of accuracy, the manner of selecting the currency to make up the sample segments should be such as to assure that the tests (1) are representative of all the currency making up the lots for destruction, and (2) expose each sorter's work to the possibility of verification on any given day.

The Board shares with the Reserve Banks a concern that the important responsibility of currency destruction be discharged with credit to the System. The Board assumes that the Auditing Departments in the Banks will give careful attention to the currency verification and destruction procedures and expects a similar careful review by its own examining staff.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS
COPIES TO CHAIRMEN AND GENERAL AUDITORS OF ALL
FEDERAL RESERVE BANKS